Report

of the

Superannuation Working Group

on

Options for Improving the Safety of Superannuation

28 March 2002

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Superannuation Working Group

SUPERANNUATION WORKING GROUP

28 March, 2002

Senator the Hon Helen Coonan
Minister for Revenue and Assistant Treasurer
Parliament House
CANBERRA ACT 2600

Dear Minister

REPORT OF THE SUPERANNUATION WORKING GROUP ON ISSUES PAPER *OPTIONS FOR IMPROVING THE SAFETY OF SUPERANNUATION*

I am pleased to present the report of the Superannuation Working Group on the Government's Issues Paper, *Options for Improving the Safety of Superannuation.*

On behalf of the members of the Superannuation Working Group, I would like to place on the record our appreciation for the frank and co-operative response to the consultation process. This process has enabled us to develop recommendations that balance all relevant interests and to give them a practical focus that addresses industry practice, while at the same time addressing areas of regulatory concern.

We have also found the consultation process helpful in identifying some areas of concern that we may not otherwise have considered. In consequence, the Superannuation Working Group has raised some issues in addition to those that were originally identified in the Issues Paper.

In relation to a number of issues, due to time constraints, it has not been possible for the Superannuation Working Group to come to a conclusive view. In those cases, we have suggested a possible direction and recommended that the Government further explore the outstanding issues, in consultation with the industry and other stakeholders.

I would also like to extend my thanks to the members of the Superannuation Working Group for their valuable assistance in preparing this report.

Yours sincerely

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ABBREVIATIONS

ADI	Authorised Deposit-taking Institution
AFSL	Australian Financial Services Licence
AGM	Annual general meeting
ALRC	Australian Law Reform Commission
APRA	Australian Prudential Regulation Authority
ASFA	Association of Superannuation Funds of Australia
ASIC	Australian Securities & Investments Commission
ATO	Australian Taxation Office
Corporations Act	*Corporations Act 2001*
Data Act	*Financial Sector (Collection of Data) Act 2001*
EPSSS	Exempt Public Sector Superannuation Scheme
FSI	Financial System Inquiry
FSRA	*Financial Services Reform Act 2001*
GIRA	*General Insurance Reform Act 2001*
Insurance Act	*Insurance Act 1973*
MIA	*Managed Investments Act 1998*
NTA	Net tangible assets
OECD	Organisation for Economic Cooperation and Development
PDS	Product Disclosure Statement
SIS Act	*Superannuation Industry (Supervision) Act 1993*
SMSF	Self managed superannuation fund
SWG	Superannuation Working Group

SUMMARY OF RECOMMENDATIONS

Universal licensing regime

APRA licence

Recommendation 1

The SWG recommends that trustees of superannuation entities (other than SMSFs or EPSSSs) be licensed by APRA. To obtain such a licence, a trustee should be required to:

- comply with conditions on a licence, with other legislative requirements and with the covenants in the trust deed;
- have adequate resources in place (financial resources (see discussion on capital under 6.1), technological and human resources);
- meet minimum standards of competency;
- have adequate risk management systems in place, including a risk management plan and adequate arrangements for ensuring compliance with the plan;
- have adequate levels of professional indemnity insurance and material damage/consequential loss insurance in place;
- have adequate outsourcing arrangements in place; and
- meet any other conditions as prescribed in regulations or as required by APRA.

Licensees would also need to meet these licence criteria on an on-going basis.

The SWG recommends that the Government consider enforcement powers to enable APRA to suspend or remove a trustee or to revoke its licence where the trustee breaches the conditions of its licence or where an existing trustee fails to obtain a licence from APRA.

Recommendation 2

The SWG recommends that the licence apply to either the trustee corporation as a whole, or where the trustee is comprised of individuals and no corporate trustee structure exists, to a 'notional entity' comprising those individuals. The SWG further recommends that the Government consider mechanisms to ensure that trustees as a whole are able to show the capacity to meet the licence criteria. This would include enabling the trustees to 'buy in' the expertise to demonstrate the competence to operate the fund, or through the application of 'key person' licensing conditions.

Recommendation 3

The SWG recommends that licensed trustees be required to register with APRA an intention to establish all funds they propose to operate prior to commencement. As a component of this registration process, trustees should be required to lodge the trust deed and a risk management plan, and certification that the trust deed and risk management plan comply with relevant requirements.

Recommendation 4

The SWG recommends that existing trustees be given up to two years from the date of commencement of legislative amendments to apply for a licence and to register existing funds. New trustees would be required to be licensed from the date of commencement of the licensing regime. Consideration will need to be given to how the licensing process can be smoothed administratively during the transitional period to ensure that a significant number of applications are not received at the end of the two year period.

ASIC licence

Recommendation 5

The SWG recommends that the requirement for an APRA licence be in addition to the FSRA requirements to have an AFSL to advise or to deal in interests of the fund. However, a trustee should not be required to have an ASIC licence to operate the fund.

Recommendation 6

The SWG recommends that the Government review the exemption from the AFSL requirements for dealing by trustees of non-public offer superannuation funds.

Single entry point

Recommendation 7

The SWG recommends that the Government consider streamlining arrangements for trustees required to hold both an APRA licence and an AFSL, through the development of a single entry point enabling trustees to lodge only one application to cover both licences. The single entry point would only apply to applications for an APRA licence and AFSL submitted after commencement of the APRA licensing requirements. The application would need to contain sufficient information to meet the requirements for both licences. In considering this recommendation, the SWG suggests that the Government examine:

- the matters that ASIC should consider when licensing an entity that has been or is to be licensed by APRA;
- the extent to which the regulators should be required to consult with each other in taking licensing action; and
- the memorandum of understanding that establishes information-sharing arrangements between APRA and ASIC.

Implementation issues

Recommendation 8

The SWG recommends that the Government consider:

- the current threshold for SMSFs to determine whether it is an appropriate test for determining which funds require prudential regulation; and
- whether the existing successor fund provisions contained in the SIS Act are appropriate to deal with any restructuring that may occur as a result of the new licensing requirements.

Risk management plans

Recommendation 9

The SWG recommends that superannuation trustees, as a condition of their APRA licence, be required to prepare and maintain a risk management plan in respect of each fund that they operate. The plan would need to be submitted as a part of the fund registration process. Trustees would be required to demonstrate in the plan how they intend to deal with specific risk areas relevant to superannuation funds, including compliance with particular provisions in the SIS Act. The Government should consult with relevant stakeholders on the risk areas that would need to be addressed in the risk management plan.

Recommendation 10

The SWG recommends that compliance with the risk management plan be audited each financial year, as a component of the fund's existing audit procedures.

Recommendation 11

The SWG recognises the diversity of trustee structures that exists in the superannuation industry, and recommends that the Government consider, in consultation with relevant stakeholders, mechanisms for independent oversight of the trustee's compliance with the risk management plan, and for reporting breaches to the regulator.

Recommendation 12

The SWG recommends that appropriate enforcement measures be put in place to address non-compliance with the risk management plan. For example, a significant breach could be required to be reported both to APRA and to members, regardless of whether steps had been taken to remedy the breach. In addition, the SWG recommends trustees be required to notify members that they may seek a copy of their fund's risk management plan from the trustee.

Prudential standards-making power

Recommendation 13

The SWG recommends that APRA be empowered to make prudential standards similar to the power it has in relation to general insurance. The SWG acknowledges that there are a number of practical implementation issues that will need to be addressed progressively in relation to such a power, in consultation with relevant stakeholders.

Longer term options — separation of prudential and retirement income provisions

Recommendation 14

The SWG acknowledges that the SIS legislation is complex, and recommends separation of the prudential and retirement income provisions of the legislation to assist in simplifying the legislation. However, the SWG notes that there are a number of practical implementation issues that will need to be addressed and consulted on in relation to such a proposal.

Prudential standards

Recommendation 15

The SWG recommends that APRA consider developing prudential standards that cover capital, investment rules, outsourcing, governance and operational risk, in consultation with relevant stakeholders.

Capital adequacy

Recommendation 16

The SWG recommends that, as a part of the licensing process, APRA should determine the amount of resources, including capital, required to be held by each trustee to address the operational risks relevant to that trustee. The legislation should list the factors APRA is required to take into account in determining an appropriate amount of capital, but should not specify a minimum or maximum amount of capital required for each trustee nor how it

should be held. APRA should also provide guidance to industry on the weightings it intends to apply to those factors. The SWG recommends that the revised capital requirements be developed in consultation with relevant stakeholders, and be phased in at the same time as the licensing requirements.

Investment rules

Recommendation 17

The SWG recommends that APRA update *Superannuation Circular No. II. D.1 — Managing Investments and Investment Choice (April 1999)*.

Recommendation 18

The SWG recommends that trustees be required to:

- ensure that the fund's objectives are clearly articulated; and
- identify in their risk management plan the measures that the trustee is adopting to ensure that the fund's investment strategies match the fund's objectives, and are in compliance with the sole purpose test contained in section 62 of the SIS Act.

The SWG also recommends that trustees be required to certify whether a fund's investment strategy is in compliance with the fund's objectives. This would be subject to the fund's annual compliance audit.

Outsourcing

Recommendation 19

The SWG recommends that, as a condition of the APRA licence, trustees be required to include a term in any contracts with third party service providers that provides APRA with a right of access to the service provider in the event that APRA has concerns about the impact of the activities of the service provider on the APRA-regulated entity. The SWG also considers that APRA should be required to notify other trustees using the same service provider of any concerns APRA may have in relation to the service provider.

Governance and operational risks

Recommendation 20

The SWG recommends that, as a component of the licensing framework, trustees be required to demonstrate in their risk management plan how they propose to deal with governance and risk management requirements.

Annual meetings

Recommendation 21

The SWG recommends that the proposals contained in the Issues Paper, to require superannuation funds to hold AGMs or that members be given the right to request a meeting at any time, not be proceeded with.

Public disclosure of annual returns

Recommendation 22

The SWG recommends that for funds other than those with fewer than five members and EPSSSs, ASIC use its existing electronic facilities to make the audited accounts of funds and the fund information required to be given to members publicly available, provided the costs are reasonable.

Recommendation 23

The SWG recommends that trustees be required to notify superannuation fund members of the presence, and nature, of any qualification of the fund's auditor's report.

Member approval for giving benefits to related parties

Recommendation 24

The SWG recommends that the Government consider reducing the length of time that grandfathering arrangements contained in Part 8 of the SIS Act apply for all funds other than SMSFs.

Recommendation 25

The SWG recommends that trustees be required to disclose in their PDS any in-house assets held by the fund.

Recommendation 26

The SWG recommends that trustees be required to disclose non-investment transactions entered into with related parties.

Financial assistance to failed superannuation funds

Recommendation 27

Given that the current provisions contained in Part 23 of the SIS Act have not yet been fully tested, the SWG recommends that the provisions not be changed at this time. However, the SWG recommends that the Government review the operation of Part 23 and consider possible amendments to it, in consultation with relevant stakeholders, once the first decision under Part 23 has been made.

Contributions

Recommendation 28

The SWG recommends that the Government consider examining the need to specify a timeframe within which salary sacrifice superannuation contributions should be paid to a superannuation fund on behalf of an employee.

1 INTRODUCTION

Background to the Report

On 2 October 2001 the Government released an Issues Paper, *Options for Improving the Safety of Superannuation* (the Issues Paper). The Issues Paper raised a number of proposals for the supervision and governance of superannuation entities.

A Superannuation Working Group (SWG) was established to conduct consultations on the Issues Paper proposals and to develop legislative options to put to the Government. The SWG comprised representatives from the Treasury, the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) and was chaired by Mr Don Mercer. This Report contains the SWG's recommendations for legislative reform, incorporating views expressed in the public consultation process.

The consultation process involved written submissions and two rounds of public consultations: a roundtable of stakeholders was held in Canberra on 13 December 2001, and further focus group discussions were held in Sydney and Melbourne on 6 and 7 March 2002, respectively.

Following the December consultations, the SWG released a Background Issues Paper on 24 December 2001. This paper fleshed out in greater detail some of the proposals in the Issues Paper, particularly in light of comments received at the consultation meeting, along with a summary of the views expressed on particular proposals at the meeting. To promote a more fulsome discussion about the options for improving the safety of superannuation, that paper went further, in some respects, than the proposals raised in the Issues Paper. However, it did not purport to be a complete analysis of all the relevant issues.

Written submissions were sought by 1 February 2002. The SWG received 52 submissions from a wide range of stakeholders, including industry associations, individual funds and service providers, consumer groups and individuals. A list of submitters who did not indicate that their submissions were to be treated as confidential is provided in Appendix 1.

Following consideration of the submissions and the discussion at the meeting held in December, the SWG prepared a further document containing draft recommendations for discussion at the March focus group discussions. Those

draft recommendations have been further refined as a result of the feedback received at the March meetings, and are now reflected in the final recommendations to Government contained in this Report.

The members of the SWG would like to place on the record their appreciation for the frank and co-operative response to the consultation process. We believe that the process has enabled us to develop recommendations that appropriately balance all of the interests associated with the regulation of superannuation and to give them a practical focus that addresses industry practice.

That said, we have not adopted all of the views expressed in submissions or during consultations. The overriding objective has been to ensure that the regulatory framework for the superannuation industry is robust and provides adequate levels of safety for the retirement savings of the community. In relation to some proposals, we have taken the view that reform is necessary to achieve this objective, notwithstanding that there has been some opposition to proposals expressed during consultations. In this Report we seek to explain why we have adopted that approach.

Purpose of proposals

The Issues Paper indicated that there had been an increasing focus on the regulation of the superannuation industry given some recent well-publicised failures, the collapse of the HIH Insurance Group and comments made by the Reserve Bank Governor (as an Australian Prudential Regulation Authority (APRA) Board member). It also identified some of the particular supervisory challenges faced by APRA in relation to superannuation.

In response to these concerns, the SWG was asked to consult on a limited range of issues directed at ensuring that the prudential regulatory framework for the superannuation industry is robust and provides adequate levels of safety for the retirement savings of the community. There are a number of other reviews and inquiries considering aspects of the regulatory framework for superannuation, some proposals for change and some recent legislative amendments (see Appendix 2). The SWG's recommendations need to be considered in the context of these other processes and changes, as they address particular concerns about the regulatory framework for superannuation, rather than providing a complete answer. The scope of the review was deliberately limited to proposals for improved prudential supervision that could be implemented at the earliest possible time. That underlying objective has been reflected in the SWG's recommendations.

One of the themes in a number of submissions to the SWG was that there had not been sufficient identification in the Issues Paper or in the subsequent Background Issues Paper of the particular areas of concern. The view was put that those areas of concern should be analysed in detail, and the proposals should be specifically targeted to the problem areas and costed prior to being recommended. It was also noted by some that the most significant recent failures had been in relation to funds with Approved Trustees, and thus queries were raised about applying a licensing regime to all trustees. In particular, some suggested that to the extent that the Issues Paper identified concerns, they were largely in relation to trustees of small corporate superannuation funds and thus the proposals for reform should be directed at those trustees.

The SWG takes the view that while many areas of the regulatory framework are operating effectively, it is an opportune time to consider the current framework from a 'preventative maintenance' perspective. One lesson learnt from recent failures, both in Australia and internationally, is that the costs of rectifying problems after the event may far exceed the costs of preventing those problems from occurring in the first place. In addition, the costs associated with past experience are not representative of the costs of fund failure which may be experienced in the future. Examples of recent large-scale corporate collapses demonstrate the need for vigilance by policy makers and regulators to ensure that the regulatory framework is operating effectively, and that the regulator is appropriately resourced and able to deal with issues at an early stage. In response, the SWG has been conscious of the need to create a robust prudential regime which is administered by a competent and well-resourced regulator.

The SWG also acknowledges that the Issues Paper identified specific examples of concerns in relation to small corporate superannuation funds. However, during the course of the consultation process, APRA has provided anecdotal evidence accumulated on an on-going basis of wider spread problems across the superannuation industry. Although APRA seeks to address these issues through its on-going supervision, weaknesses in the current regulatory toolkit, and the resource intensiveness of addressing issues through on-going supervision makes this a difficult task. The SWG believes that the concerns need to be addressed more proactively through legislative reform.

In addition, examples provided in Appendix 3 confirm that problems manifest in funds both with and without Approved Trustees. Many of these concerns relate to poor investment practices, often arising from flawed management practices and procedures. Evidence provided to the Senate Select Committee on Superannuation and Financial Services also identified concerns stemming

from a lack of experience and knowledge of the legislation governing superannuation funds; a lack of monitoring by trustees of the superannuation fund's operations; and a lack of appropriate internal controls to ensure that funds are being managed in accordance with superannuation legislation and the governing rules.[1] The SWG's recommendations seek to address similar concerns.

In light of this, the SWG believes it is necessary to consider the appropriateness of the prudential regulatory framework as a whole for all superannuation funds, rather than targeting specific areas of concern. If that framework is appropriate, then the risk of problems arising in particular areas will be minimised. However, as noted by the Financial System Inquiry (FSI), those risks cannot and should not be completely eliminated.[2] One of the key functions of financial markets is to price that risk. Furthermore, fraud cannot be absolutely regulated against, but threshold licensing requirements and on-going monitoring obligations can assist in minimising it.

The SWG has considered the appropriate prudential regulatory framework for all superannuation funds. However, the SWG acknowledges that there is significant diversity in structure and size of superannuation funds. It has sought to address that diversity through recommending a set of general principles capable of application across all funds, but with in-built flexibility to recognise the diversity of different funds.

The SWG also acknowledges the differences between those funds with a representative trustee structure and those without, and believes there can be considerable strength in the representative trustee structure. A number of submissions took the view that the representative trustee structure justified a significantly different regulatory structure to that applying to other superannuation funds. In particular, the view was put that there were different incentives and motivations between not-for-profit funds and those funds that are operated for profit.

The SWG does not deny those differences, but believes that they do not justify a radically different regulatory regime. Regardless of whether a fund is run for profit or not, members need to have the same confidence in the soundness of the trustees to manage their retirement savings. A representative trustee

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1 Senate Select Committee on Superannuation and Financial Services 2001a, *Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services*, First Report (Senator J. Watson, Chair), Canberra, August, paragraph 3.17.

2 Financial System Inquiry 1997, *Financial System Inquiry Final Report*, (Mr. S. Wallis, Chairman), Australian Government Publishing Service, Canberra, March, paragraph 5.1.

structure, while giving employees a voice in running the fund, does not guarantee the competence of those trustees to operate the fund. For this reason, the SWG believes that its recommendations are equally appropriate to funds that are not operated for profit and those that are — in fact, as noted above, the SWG's recommendations provide some in-built flexibility.

In relation to the costs of the proposals, in most cases the SWG's recommendations are intended to reflect nothing more than good trustee practice, and should not represent a significant cost to well-run funds. In addition, as with the costs of poor trusteeship, the benefits of good trusteeship are systemic and difficult to quantify. However, the SWG recognises that trustees may be concerned about the costs of implementing the SWG's recommendations. Many of the recommendations are at relatively high level of generality with acknowledgement that further consideration will need to be given to the detail in developing the legislation. The SWG is recommending that the Government consult closely with all relevant stakeholders in the development of the legislation to ensure that the changes are not unrealistic or unduly costly. It will also be necessary to prepare a Regulation Impact Statement assessing the costs and benefits in the development of the legislative proposals.

Enforcement focus

Another significant theme running through submissions was that the basic legislative framework for the regulation of superannuation was sound and what was really needed was a well-resourced regulator with an enforcement focus. A number of submissions took the view that it was not appropriate to give APRA further powers until it had fully used all of the powers that it currently has.

The SWG considers that the soundness of the regulatory framework and the ability of the regulator to enforce that framework are two distinct issues. They are not alternatives to a robust superannuation industry, but are both essential components.

The focus of the SWG has been on the regulatory framework, and not the resourcing or practices of the regulators. However, the SWG agrees that a well-resourced regulator with a strong enforcement culture is vital to a healthy superannuation industry. Some changes have already been made to assist APRA with its enforcement activities. A number of other inquiries are considering whether further changes and additional resourcing are necessary to assist APRA.

- In 2001, APRA received $2.1 million for 2001-02, and $3.1 million for 2002-03 and on-going, for increased prudential supervision of superannuation.

- APRA has significantly increased supervisory activity of superannuation funds. Visits to individual funds are expected to increase from just under 600 in a year to June 2001 to around 1,000 in the current financial year. Around 80 consultations or visits will also be held with Approved Trustees or financial conglomerates which include superannuation entities.

- The *Financial Sector Legislation Amendment Act 2001* commenced in January 2001. The Act provided the regulators (APRA, Australian Securities & Investments Commission (ASIC) and the Australian Taxation Office (ATO)) with a range of new enforcement powers, including the power to disqualify persons considered not 'fit and proper' to be involved in administering superannuation, and the ability to accept voluntary undertakings from persons involved in superannuation administration, and to enforce such undertakings through a Court. The Act also converted certain offence provisions under the SIS Act from fault liability to strict liability, and converted some fault liability offences to two-tier offences with both fault and strict liability limbs.

- APRA is in the process of refining the annual returns and reporting requirements for superannuation funds to ensure that data reported by funds is comprehensive and accurate, with the ultimate aim of ensuring that information is timely and relevant, and assists APRA to identify and address areas of potential concern before they become significant.

The SWG encourages further consideration of changes necessary to ensure that there is appropriate enforcement of the regulatory framework.

However, the problems identified with the operation of some superannuation funds indicate that the regulatory framework is not perfect and requires some modification. It is also far from clear that greater enforcement activity by APRA will necessarily address all of the problems. In particular, given the large number of funds in the industry, it would be extremely resource-intensive and costly for APRA to closely monitor all funds. The SWG's recommendations seek to reduce the on-going monitoring burden upon APRA through minimum entry requirements, greater disclosure and requiring trustees to have a greater compliance focus.

2 UNIVERSAL LICENSING REGIME

Proposal

The Government invites comments on whether to apply a universal licensing regime to superannuation funds and, in particular, on the options:

- *of requiring trustees to hold an Australian Financial Services Licence (AFSL) to operate and issue interests in a fund (similar to the obligations on responsible entities of managed investment schemes); and/or*
- *of requiring trustees to hold an APRA licence similar to the obligation on all other prudentially regulated financial institutions; and*
- *relating to the form of minimum entry and operating standards that might be set by APRA.*

The Background Issues Paper (released on 24 December 2001) characterised the licensing options as: Option 1 — an AFSL licence to operate and issues interests in a fund; Option 2 — an APRA licence; and Option 3 — for the trustee to hold both an AFSL and APRA licence.

Views from the consultation process

There was general support in submissions for a universal licensing regime for all superannuation funds. For example, AMP Limited stated that 'the safety of superannuation would be increased if all trustees were to be licensed (approved) as part of a broad risk based assessment of all managed funds.'

A number of submissions expressed concern that the need to hold two licences could lead to duplication and a blurring of the demarcation of responsibilities between APRA and ASIC. Many submissions (including those from the Australian Industry Group, the Coles Myer Superannuation Fund, CPA Australia, the Institute of Actuaries, the Law Council of Australia and the Industry Funds Forum) argued that there should be only one regulator issuing licences. Most indicated that as APRA was the body responsible for regulating the safety of superannuation, it should be the sole provider of a licensing system for superannuation trustees, although a few favoured an ASIC-only licence.

Submissions that did not support universal licensing focussed on concerns about the licensing of individual trustees and directors of corporate trustees (the Australian Council of Trade Unions) and not-for-profit corporate and industry funds. There was concern that licensing in such circumstances would diminish the opportunities for employee representation and reduce the diversity of trustees.

Some submissions also expressed concern about the potential costs of a licensing regime, particularly for smaller funds, and emphasised that licence criteria and the types of licence issued should take account of the nature of the trustee and types of funds being regulated. The Association of Superannuation Funds of Australia (ASFA) also flagged a need for better co-operation and information sharing between the regulators.

ASFA also emphasised the need to consider licensing within the broader regulatory framework, and indicated that '[t]he large number of funds means that licensing alone … will have limited use and must be supported through strong on-going and ex-post supervision.'

During focus group sessions held in March 2002, participants indicated that the costs associated with requirements for an APRA licence should be quantified, and suggested that the SWG make it explicit whether restructuring is anticipated as an outcome of these reforms. Participants reinforced the need to avoid duplication and overlap of APRA and ASIC requirements with regard to the single entry point, and requested that the draft recommendations clarify that trustees have the ability to 'buy in' the expertise required to meet the licence criteria. The concept of a 'key person' licence requirement was suggested as a method of ensuring that the critical skills required to demonstrate competence to run the fund are retained by the trustees. Participants also requested clarification of the consequences of breaching the conditions of one licence (either the APRA licence or AFSL) where a trustee is subject to dual licensing.

As noted above, the SWG believes that it is more appropriate to cost the recommendations in consultation with all relevant stakeholders once they are fleshed out in greater detail in the development of the legislation.

Consideration of the proposal

Background

One of the key outcomes of the Financial System Inquiry (FSI) was the establishment of a 'twin-peaks' model for regulation of the financial services industry. Under this model, APRA is responsible for prudential regulation and ASIC for consumer protection and market integrity regulation.

Licensing is one of the regulatory tools that can be used to address both prudential and consumer protection issues. In establishing the twin-peaks model, the FSI envisaged that both APRA and ASIC would have licensing systems available to them. However, the licence criteria would differ depending on the regulatory aims that the particular licence is directed at. The FSI noted that there would need to be close co-operation between the regulators.[3]

A licensing system under which one regulator, such as APRA, is solely responsible for licensing to address both prudential and consumer protection issues would be inconsistent with the regulatory framework that has been established following the FSI.

Dual licensing already exists for many Approved Trustees. Following the commencement of the *Financial Services Reform Act 2001* (FSRA) on 11 March 2002, it also exists for many other APRA-regulated bodies, including Authorised Deposit-taking Institutions (ADIs) and insurance companies. As noted above, the APRA and ASIC licences are addressed at different regulatory aims and this is reflected in the licence criteria. In some cases, similar requirements will apply, such as competency, but for different regulatory purposes. Consideration needs to be given to whether the requirements for one regulatory purpose can be taken to be sufficient to meet those imposed for the other regulatory purpose. For example, under the FSRA, licence criteria addressed at the adequacy of resources and risk management systems are not required to be met by APRA-regulated bodies on the basis that APRA's requirements already address these criteria completely.[4]

For other criteria, it may not be possible to say that the assessment by one regulator completely addresses the regulatory purposes of the other regulator. For example, an assessment by APRA that an institution is 'fit and proper' to

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3 Financial System Inquiry 1997, paragraph 8.3.

4 Paragraph 912A(1)(d) of the *Corporations Act 2001* inserted by the FSRA.

be an ADI, while relevant, may not fully address ASIC's assessment of whether the institution is competent in its dealings with individual customers. In such circumstances, it may be appropriate for one regulator to have regard to an assessment made by another, without making it determinative.

APRA licence

While it would be inconsistent with the post-FSI regulatory framework to have a licence directed towards both prudential and consumer protection issues administered by a single regulator, there remains a question of whether licences are necessary to address both of these regulatory aims. Option 1 in the Background Issues Paper, an AFSL alone, was premised on the assumption that a consumer protection licence might be sufficient and that no further licensing was needed to address prudential issues. As noted in the Issues Paper, however, such a licensing regime would not obviate the need for increased prudential oversight of smaller funds. The issue is whether a prudential licence is necessary to provide for that increased oversight, or whether it can be achieved in other ways.

In subsequent recommendations, the SWG, with support from a significant number of submissions, sees an important role for risk management plans in addressing prudential regulatory issues. While a risk management plan could be a stand-alone requirement, experience under the *Managed Investments Act 1998* (MIA) regime is that compliance plans work extremely effectively as part of a licensing regime. Similarly, while it would be possible for one regulator to assess licensing and another to assess the risk management plan, outcomes are more likely to be better co-ordinated and more cost effective for both the regulators and the industry if the same regulator that assesses licensing also assesses the risk management plan requirements.

The role of the risk management plan envisaged by the SWG is largely aimed at demonstrating how the trustee intends to deal with the key risks associated with investment, outsourcing, governance and risk management issues. These are largely matters of more significance to the prudential regulator than they are to the consumer protection regulator. In light of this, the SWG believes that it is not appropriate solely to have a consumer protection licence, but that licensing is also necessary for prudential purposes. Thus the SWG does not favour Option 1 and believes that trustees of superannuation funds should be required to be licensed by APRA.

Recommendation 1

The SWG recommends that trustees of superannuation entities (other than self managed superannuation funds (SMSFs) or exempt public sector superannuation schemes (EPSSSs)) be licensed by APRA. To obtain such a licence, a trustee should be required to:

- **comply with conditions on a licence, with other legislative requirements and with the covenants in the trust deed;**
- **have adequate resources in place (financial resources (see discussion on capital under 6.1), technological and human resources);**
- **meet minimum standards of competency;**
- **have adequate risk management systems in place, including a risk management plan and adequate arrangements for ensuring compliance with the plan;**
- **have adequate levels of professional indemnity insurance and material damage/consequential loss insurance in place;**
- **have adequate outsourcing arrangements in place; and**
- **meet any other conditions as prescribed in regulations or as required by APRA.**

Licensees would also need to meet these licence criteria on an on-going basis.

The SWG recommends that the Government consider enforcement powers to enable APRA to suspend or remove a trustee or to revoke its licence where the trustee breaches the conditions of its licence or where an existing trustee fails to obtain a licence from APRA.

As suggested in the Background Issues Paper, the SWG considers that it should be the corporate trustee, or in the case of individual trustees, the 'notional trust entity' that is licensed.[5] Thus each individual trustee would not be required to meet the licence criteria in their own right, but rather the trustee entity as a whole must satisfy the licence criteria. The licence might also

5 Superannuation Working Group 2001, *Options for Improving the Safety of Superannuation Background Issues Paper*, Canberra, December, pp. 5-6.

include a 'key person' condition to require an individual who holds the critical skills necessary to demonstrate competence to operate the fund to continue to be involved in running the fund. These initiatives should address concerns that licensing might diminish the opportunities for employee representation and reduce the diversity of trustees.

Further, the SWG considers that, consistent with the approach that ASIC is taking with AFSLs, trustees should be able to outsource the satisfaction of the licensing obligations to third parties. For example, the trustees could 'buy in' the expertise to show the competence to operate the fund. However, the trustees would be required to satisfy the regulator that they have appropriate systems in place to manage any outsourced functions.

Recommendation 2

The SWG recommends that the licence apply to either the trustee corporation as a whole, or where the trustee is comprised of individuals and no corporate trustee structure exists, to a 'notional entity' comprising those individuals. The SWG further recommends that the Government consider mechanisms to ensure that trustees as a whole are able to show the capacity to meet the licence criteria. This would include enabling the trustees to 'buy in' the expertise to demonstrate the competence to operate the fund, or through the application of 'key person' licensing conditions.

In addition to licensing superannuation trustees, the SWG believes that there would be considerable merit in requiring trustees to register with APRA each of the funds for which they act as trustee. One of the regulatory difficulties identified by APRA is that a fund can be started up without APRA having any prior notice. APRA only becomes aware of the existence of the fund when an election is made under section 19 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to be a regulated fund for the purposes of that Act. That notice is required to be given within 60 days of the fund being established.

By contrast, under Part 5C of the *Corporations Act 2001* (Corporations Act), in addition to the responsible entity of a managed investment scheme being required to be licensed, each managed investment scheme must also be registered with ASIC and a compliance plan must be lodged for each scheme. This registration process gives ASIC the opportunity to ensure that the responsible entity is appropriately licensed, that it will be able to comply with its obligations in relation to the particular scheme, that the conditions on its licence remain appropriate for that scheme and that it has a compliance plan for that scheme.

The scheme registration process itself is not as detailed as the licensing process. It requires the lodgment of the scheme's constitution, the compliance plan and a statement signed by the directors that the constitution and compliance plan meet the requirements of the law. ASIC must register the scheme unless the responsible entity is not appropriately licensed or the constitution and compliance plan do not meet the requirements of the law.

It would not be possible for the trustees of superannuation funds to register funds prior to commencement of operations, since until contributions (trust property) are made to a fund, a fund does not exist as a trust. Thus, in relation to superannuation funds, the SWG considers that trustees should be required to provide notice of an intention to establish a fund. It should be a requirement that trustees cannot accept contributions into a fund unless the fund is registered. Consideration will also need to be given to how the requirement to register a fund would operate in the context of the current requirement to notify of intention to be regulated under the SIS Act within 60 days. It may be that the latter requirement can be brought forward to the time of registration of the fund.

The SWG suggests that as a component of this registration or notification of intention process, trustees should be required to lodge the trust deed and a risk management plan (see discussion of requirements in Chapter 3 of this report indicating why the SWG is recommending development of a 'risk management plan' rather than a 'compliance plan'). The trustee should also be required to lodge certification that the trust deed and risk management plan comply with relevant requirements.

It was noted by some during the consultation process that it may be difficult to prepare a detailed risk management plan for start-up funds, as the full details of proposed operations will not be known prior to the commencement of operations. It was suggested that a truncated plan be lodged at that time, with a detailed plan being lodged after the fund had been in operation for some time. The SWG believes that it is appropriate for trustees to lodge a full risk management plan on commencement, but believes that consideration will need to be given to whether trustees should be required to submit a revised risk management plan at a later date (for example, to coincide with the first inspection by APRA), or whether the trustee would be required to submit a new risk management plan to the regulator each time it is changed significantly. Regardless of lodgment requirements, the SWG envisages that risk management plans will be living documents that will be adjusted and modified as necessary to address changes in fund operations.

Recommendation 3

The SWG recommends that licensed trustees be required to register with APRA an intention to establish all funds they propose to operate prior to commencement. As a component of this registration process, trustees should be required to lodge the trust deed and a risk management plan, and certification that the trust deed and risk management plan comply with relevant requirements.

Recommendation 4

The SWG recommends that existing trustees be given up to two years from the date of commencement of legislative amendments to apply for a licence and to register existing funds. New trustees would be required to be licensed from the date of commencement of the licensing regime. Consideration will need to be given to how the licensing process can be smoothed administratively during the transitional period to ensure that a significant number of applications are not received at the end of the two year period.

ASIC licence

Option 2 in the Background Issues Paper, an APRA-only licence, implied that licensing was not necessary for consumer protection purposes and that a prudential licence would be sufficient, with consumer protection aims being achieved in other ways. As noted above, the licence criteria for an ASIC licence are directed towards consumer protection aims. Such a licence has been in place for trustees of some superannuation funds under the former Corporations Law (now Corporations Act) since the SIS Act was introduced, and following the commencement of the FSRA will be extended to a wider range of APRA-regulated bodies. As a consumer protection measure, licensing has long been considered a necessary regulatory tool in the financial services industry to impose minimum entry levels. The SWG does not consider that it would be appropriate to remove outright the current consumer protection licensing regime for superannuation trustees.

Option 3 suggested dual licensing by APRA and ASIC, in recognition of the fact that licensing can address both prudential and consumer protection issues. The SWG is of the view that this is the appropriate outcome consistent with the post-FSI regulatory framework. It is also consistent with the recommendation of the Productivity Commission in its draft report, *Review of the Superannuation*

Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation, that superannuation entities be licensed by APRA subject to specific conditions.[6]

However, the SWG is conscious of the need to avoid regulatory overlaps that might impose undue costs on industry and, in turn, fund members. In view of this, the SWG does not believe that the ASIC licence should be extended to the operation of the fund, but should only apply to dealing in and/or advising on interests in the fund. This differs from the approach under the Corporations Act for managed investment schemes, the responsible entity of which is required to be licensed to operate, deal and advise. However, managed investment schemes are not subject to any prudential regulation, thus to achieve consumer protection aims it is important that the licensing requirements also address the entity's ability to operate the fund. Nonetheless, in considering the dealing activity of trustees in superannuation funds, ASIC will consider many matters that are also relevant to the operation of the fund.

Recommendation 5

The SWG recommends that the requirement for an APRA licence be in addition to the FSRA requirements to have an AFSL to advise or to deal in interests of the fund. However, a trustee should not be required to have an ASIC licence to operate the fund.

There is also a question of whether it is appropriate to continue the FSRA exemption for non-public offer funds dealing in interests in the fund. Under the FSRA, such funds will only require an AFSL for advising on interests in the fund.

While the precise number of trustees that will be licensed under this requirement is not known at this stage, it is likely that some trustees of non-public offer funds will require an AFSL. Those trustees that will be licensed will be required to have in place compensation arrangements to cover loss or damage as a result of breaches of the law in relation to their advising activity. However, there will be no requirement for compensation arrangements for loss or damage suffered as a result of problems in the issuing of interests. Thus there will be a gap in the coverage of compensation arrangements in relation to dealing activity by trustees of non-public offer funds.

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6 Productivity Commission 2001, *Review of the* Superannuation Industry (Supervision) Act 1993 *and Certain Other Superannuation Legislation*, Draft Report, Canberra, September, Draft Recommendation 7.1.

Given that the SWG is recommending that these trustees obtain an APRA licence and will be required to meet standards of competence and other licence criteria, it may not be a significant additional burden for such trustees to also obtain an AFSL to deal. This is particularly so given the recommendations that the SWG is making in relation to a single entry point and avoiding overlaps.

If it is not considered appropriate to require trustees of such funds to have an AFSL, the SWG believes that such trustees should be required to have compensation arrangements in place (perhaps as a condition of their APRA licence) to cover loss or damage suffered as a result of problems in issuing interests. However, it should not be necessary for APRA to establish its own procedures for determining the adequacy of compensation arrangements in relation to such activities. Under the FSRA, ASIC is already required to assess the adequacy of compensation arrangements. APRA could rely on ASIC's assessment of the adequacy of compensation arrangements in determining whether trustees have appropriate compensation arrangements.

Recommendation 6

The SWG recommends that the Government review the exemption from the AFSL requirements for dealing by trustees of non-public offer superannuation funds.

Single entry point

As noted above, the SWG favours both prudential and consumer protection licences, which for some trustees will mean both an APRA and ASIC licence. The SWG is conscious of the need to reduce compliance costs to the greatest extent possible and to avoid overlaps in the licence criteria. While dual regulators of the financial services industry are a necessary consequence of the FSI 'twin-peaks' model, the SWG recognises that for superannuation in particular there may be a need to ease the burden of having to deal with two regulators for the same business. Unlike other prudentially regulated sectors, there is a much wider diversity in size and type of trustees in relation to superannuation. For the smaller non-public offer funds in particular, having to deal with two licensing processes may be a significant burden.

The SWG considers that the Government should explore the possibility of providing a single entry point for licensing of superannuation trustees by APRA and ASIC. The SWG is of the view that, if it is feasible from a systems perspective, it would be appropriate for trustees to apply to one regulator and include in that application process all of the information required for both the

APRA and ASIC licences. Thus, at least at the initial licensing stage, applicants would have a single interface with the regulators. Further into the licensing process, applicants will, of course, have to deal with both regulators, particularly when conditions are imposed on the licence. The SWG believes that further work should be done by the regulators in making the dual interface as user-friendly as possible.

Regard will need to be had to the existing processes that the regulators have in place (including the new e-licensing system that ASIC has established for the FSRA), the costs of establishing a new system and the benefits to industry of a single entry point process.

In addition to considering arrangements for streamlining the licensing process, the SWG also believes that there are a number of areas in which overlaps in the licence criteria should be specifically addressed in the legislation. In particular, as noted above, under the FSRA, APRA-regulated bodies are not required to meet the requirements for adequate resources and risk management systems as part of their AFSL. The SWG believes this is appropriate and should apply to superannuation trustees who will be required to have both an APRA and ASIC licence.

Further, the SWG believes that there is scope for the regulators to take into account each other's assessments in relation to the other licence criteria. Both regulators will be required to assess trustees' competence. However, they will be assessing competence for different activities. APRA will be assessing trustees' competence to operate a fund in a prudent manner, while ASIC will be assessing trustees' competence to deal in and/or advise on interests in a fund. While the activities are different, many of the matters that each regulator will take into account in assessing competence may be similar.

The SWG does not believe that it is appropriate for ASIC to have regard definitively to APRA's assessment of competence. However, it believes that ASIC should be required, as a matter of law, to have regard to APRA's assessment of competence.

Recommendation 7

The SWG recommends that the Government consider streamlining arrangements for trustees required to hold both an APRA licence and an AFSL, through the development of a single entry point enabling trustees to lodge only one application to cover both licences. The single entry point would only apply to applications for an APRA licence and AFSL submitted after commencement of the APRA licensing requirements. The application

would need to contain sufficient information to meet the requirements for both licences. In considering this recommendation, the SWG suggests that the Government examine:

- **the matters that ASIC should consider when licensing an entity that has been or is to be licensed by APRA;**
- **the extent to which the regulators should be required to consult with each other in taking licensing action; and**
- **the memorandum of understanding that establishes information-sharing arrangements between APRA and ASIC.**

Implementation issues

While the SWG has been conscious of minimising the compliance costs of licensing to the greatest extent possible, it may be that for some smaller funds the compliance costs of licensing, together with the other obligations being recommended by the SWG, make it uneconomic to continue to operate.

One avenue for enabling smaller funds to continue to operate without the cost of regulation by APRA may be for them to move into the SMSF regime administered by the ATO. However, the current threshold for SMSFs may be an impediment to some funds being able to move out of the APRA regime. The SWG believes that there may be some merit in reviewing the threshold for SMSFs. Such funds could restructure if necessary and move to the ATO regulatory regime. The Small Independent Superannuation Funds Association has suggested that the test should be based on whether there are any arm's length members, rather than on a particular number (currently fewer than five).

A recent breakdown of APRA-regulated funds in terms of numbers of members (at Table 2.1) shows that a large number of APRA-regulated superannuation funds (over 8,000) have fewer than five members, but for whatever reason, these funds do not fall within the SMSF definition. By comparison, only just over 1,100 funds fall within the next two categories (funds with five to nine members, and funds with 10 to 19 members). There are just over 500 funds in the 20 to 99 member category.

Table 2.1 suggests that a quantitative change alone to the SMSF test to increase the number of members who would also be trustees of the fund would not result in substantial numbers of funds moving out of the APRA regulatory regime. Rather, changes to the SMSF definition would need to be of a

qualitative nature. The SWG recognises that this is a sensitive issue, but believes that it is one that is worthy of consideration to assist smaller funds in adjusting to the new regulatory regime. What will need to be determined is whether there is a more appropriate test for assessing which funds should be subject to prudential regulation and which ones do not need the same kind of intensity of regulation.

Table 2.1: APRA-regulated funds according to number of members at March 2002

Category of fund	Number of funds
Fewer than five members	8,121
5-9 members	864
10-19 members	275
20-99 members	506
More than 100 members	1,306
Total	**11,072**

Source: APRA, 2002.

Further, there are currently provisions under the SIS Act facilitating the transfer of assets to successor funds. The SWG has not considered these provisions in detail, but considers that the Government should review them to ensure that there are no unnecessary impediments to the winding up and transfer of fund assets for those trustees that do not wish to operate under the new regulatory regime.

Recommendation 8

The SWG recommends that the Government consider:

- **the current threshold for SMSFs to determine whether it is an appropriate test for determining which funds require prudential regulation; and**
- **whether the existing successor fund provisions contained in the SIS Act are appropriate to deal with any restructuring that may occur as a result of the new licensing requirements.**

3 RISK MANAGEMENT PLANS

Proposal

The Government welcomes comments on whether compliance plans should be required for superannuation funds.

A compliance plan is a document that sets out the measures an entity will apply to ensure that it complies with the law and its constitution.

Views from the consultation process

A majority of submissions supported the introduction of compliance plans. There was a general (but not universal) consensus that the benefits would far outweigh the costs. Furthermore, submissions agreed that compliance plans strengthen monitoring and help ensure that risks are adequately identified, considered and addressed. Different views were expressed on whether, where functions were outsourced, the compliance plan should be limited to functions undertaken by trustees. CPA Australia suggested requiring regular audit sign-off.

Some submissions drew an explicit link between this proposal and licensing. While supporting a compliance plan requirement, one submission cautioned that by requiring trustees to focus on the details of their compliance arrangements, trustees may lose sight of the 'big picture'.

The Corporate Superannuation Association opposed the proposal on the grounds that it would add little, if any, value to the existing requirements of the SIS Act. A small number of other submissions also opposed it because it is already best practice and appropriate for larger funds; because required plan content would need to be specified; or because any additional benefits were expected to be outweighed by the costs.

Participants at both focus group sessions emphasised that the compliance plan requirements for managed investment schemes may not be appropriate for the superannuation industry and suggested that, to avoid confusion, it would be better to use new terminology, such as a 'risk management plan'. It was agreed that the concept of a risk management plan captures more effectively the aims of the proposal than a compliance plan, particularly as it is envisaged that the plan would require the trustee board to focus broadly on particular risk areas

rather than necessarily on detailed compliance with legislative requirements. However, it was noted that compliance is a subset of risk management, and that preparation and audit of a full risk management plan may be costly.

Participants queried the need to submit a fully developed plan at the time of registration of a new fund, and suggested it may be more appropriate to provide an interim plan at registration, with a full plan to be submitted within a specified period of time. Participants raised concerns about APRA's administrative role in receiving and storing new or amended plans. Participants also queried whether it would be acceptable to use and submit a 'generic' plan for a particular class of funds. It was noted that this would depend upon the level of variation in the class of funds, but that master trust subfunds would be able to incorporate information by reference from other risk management plans.

Participants sought clarification of the ability to 'buy in' expertise, particularly for small funds. Participants also discussed other mechanisms for independent oversight of compliance with the plan.

Consideration of the proposal

Compliance plans codify risk management processes and practices that a well-run trustee would go through as a matter of course. ASIC has indicated that they are an essential piece of the regulatory framework for managed investment schemes, and one of its most useful tools in enabling early detection of problems.

The SWG agrees with submissions that there is considerable merit in requiring trustees of superannuation funds to prepare and lodge with the regulator a document which articulates the risk management processes and practices that the trustee proposes to follow in respect of the fund. Further, the SWG agrees that it is important to reduce compliance costs associated with this requirement to the maximum extent possible, while maintaining the effectiveness of the compliance plan regime which exists under the Corporations Act.

The compliance plan requirements for managed investment schemes under the Corporations Act only apply to managed investment schemes with 20 or more members. They are acknowledged as being world class, but they also come at a significant cost. The impact of compliance costs on the end benefit of members in superannuation funds is an important consideration to be taken into account in determining the scope and content of any such requirements for superannuation funds. Given the long term nature of superannuation, the fact

that it is compulsory and at present many members do not have a choice of fund, there may be merit in considering reducing some of the requirements that currently apply in relation to managed investment schemes, to reduce the costs that will ultimately be borne by fund members.

As the funds of particular regulatory concern to APRA are some of the smaller funds, the SWG does not consider it appropriate to exempt smaller funds from the requirements. However, it believes that it is a further reason for considering whether all of the MIA requirements in relation to compliance plans are necessary for superannuation funds.

Under the Corporations Act, responsible entities are required to prepare a compliance plan covering all aspects of compliance with the law and their governing rules. For trustees of superannuation funds, the SWG believes that the regulatory aim can be achieved by requiring the plan to address a number of specific issues only, including investment, outsourcing, governance and risk management. This list could be expanded if necessary through regulations. This would be in addition to the more general requirement for a compliance audit as part of the audit of the fund's financial position under section 113 of the SIS Act.

Given that compliance is a subset of risk management, the SWG agrees with the views expressed during the focus group discussions that a risk management plan would be more appropriate for the superannuation industry, and that this terminology would avoid confusion with the MIA requirements. The modified terminology reflects the SWG's view that the plan need not deal only with compliance with the law, but rather with the measures that the trustee is taking to address specific risks, including compliance with particular provisions in the law.

Recommendation 9

The SWG recommends that superannuation trustees, as a condition of their APRA licence, be required to prepare and maintain a risk management plan in respect of each fund that they operate. The plan would need to be submitted as a part of the fund registration process. Trustees would be required to demonstrate in the plan how they intend to deal with specific risk areas relevant to superannuation funds, including compliance with particular provisions in the SIS Act. The Government should consult with relevant stakeholders on the risk areas that would need to be addressed in the risk management plan.

The Corporations Act also requires that compliance with the managed investment scheme compliance plan be audited annually. The SWG considers that a similar requirement should be imposed on the risk management plan proposals for superannuation funds. The SWG does not envisage that this would be a separate audit requirement, but rather that it would form part of existing auditing requirements. This should assist in reducing the costs of the auditing process.

Recommendation 10

The SWG recommends that compliance with the risk management plan be audited each financial year, as a component of the fund's existing audit procedures.

Further, under the Corporations Act where less than half of the directors of the responsible entity are independent, the responsible entity is required to establish a compliance committee. That committee is charged with monitoring the extent to which the responsible entity is complying with the plan, reporting breaches to the trustee and to the regulator where appropriate steps have not been taken to remedy the breach. The SWG recognises the diversity of trustee structures that exists in the superannuation industry, and considers that the Government should consider, in consultation with relevant stakeholders, mechanisms to provide independent oversight of compliance with the plan and to report on breaches to the regulator.

Recommendation 11

The SWG recognises the diversity of trustee structures that exists in the superannuation industry, and recommends that the Government consider, in consultation with relevant stakeholders, mechanisms for independent oversight of the trustee's compliance with the risk management plan, and for reporting breaches to the regulator.

Recommendation 12

The SWG recommends that appropriate enforcement measures be put in place to address non-compliance with the risk management plan. For example, a significant breach could be required to be reported both to APRA and to members, regardless of whether steps had been taken to remedy the breach. In addition, the SWG recommends trustees be required to notify members that they may seek a copy of their fund's risk management plan from the trustee.

4 PRUDENTIAL STANDARDS-MAKING POWER

Proposal

The Government invites comments on whether APRA should be given a specific standards-making power similar to that provided to APRA in relation to the general insurance industry in the General Insurance Reform Act 2001.

Amendments to the *Insurance Act 1973* (Insurance Act) included in the *General Insurance Reform Act 2001* (GIRA) introduced the power for APRA to make and enforce prudential standards. High order prudential principles were included in the Act, with detailed requirements for general insurance companies to be included in Prudential Standards, and underpinned by non-binding Guidance Notes. The Prudential Standards are disallowable instruments (meaning that they may be disallowed by the Parliament) and APRA is required to undertake a consultation process with industry in developing the standards.

Views from the consultation process

Submissions expressed a wide range of views on this proposal.

There was some strong support (the Australian Bankers' Association, the Trustee Corporations Association of Australia, MAP Funds Management) on the grounds that it would enable APRA to undertake appropriate prudential regulation of superannuation and provide it with the flexibility necessary to enable prudential regulation to keep pace with the evolution of the superannuation sector. For example, MAP Funds Management indicated 'it is important that APRA is able to be responsive and flexible and this proposal may assist this process.' In addition, the Australian Bankers' Association indicated that the lack of any power enabling APRA to develop prudential standards for superannuation is a significant gap in the existing arrangements that APRA has in other prudentially-regulated regimes.

However, there was also strong opposition on the grounds that such a power could give APRA de facto legislative power that would not be subject to proper legal or Parliamentary scrutiny (the Law Council of Australia, some smaller superannuation funds) or that it had not been demonstrated that any extension of existing powers was necessary (PricewaterhouseCoopers, Westscheme). The Law Council of Australia suggested that 'it would be preferable to update and simplify existing regulations'. ASFA also indicated

that, while it supported the need for a strong and pro-active regulator, it was not convinced that there was a need for this power. It was noted that better use might be made of existing powers. The Securities Institute of Australia also noted 'the highest priority is for APRA to utilise the extensive powers it already holds under the Superannuation Industry (Supervision) Act … rather than to delay enforcement action until stronger powers are legislated.'

Among those submissions expressing some degree of support, concern was expressed about the need for APRA to have the appropriate resources to enforce any new standards and the possible costs to members (HortSuper, Meat Industry Employees Superannuation Fund), the dangers of over-regulation (Commonwealth Bank of Australia) and the need to balance other objectives such as efficiency, competition, contestability and competitive neutrality. It was also observed that, although further divergence between the requirements for small and large funds may make transition from one framework to the other difficult, universal standards would impose prohibitive costs on small funds (the Institute of Chartered Accountants, NSP Buck).

A number of submissions also emphasised that industry consultation would be necessary to ensure cost-effective implementation of any standards (the Securities Institute of Australia, AMP).

During the focus group sessions, participants queried the real benefits that a prudential standards-making power would deliver, and expressed concerns about the costs of change (for the industry as well as for the regulator and Government), especially in light of views that the amendments may provide cosmetic rather than substantive changes. Some participants also challenged the need for this power in view of the existing operating standards-making powers in the SIS Act.

A number of participants also supported the need for APRA to use its current powers more effectively in preference to change in this area.

There was also concern about whether APRA would be in a position to consult effectively with such a diverse industry. In relation to consultation, a number of stakeholders indicated they felt that the process in making operating standards provided greater transparency when compared with prudential standards. Concerns were also expressed about how APRA would manage consultation with other Government stakeholders to ensure that prudential standards prepared by APRA align with other aims objectives of the SIS Act, and general concerns about consistency of approach.

The Australian Bankers' Association strongly reiterated comments which they provided in their submission in support of a prudential standards-making power.

Consideration of the proposal

The arguments in support of the proposal for APRA to have a prudential standards-making power, as highlighted in the Issues Paper and in submissions, include that such a power would:

- implement recommendation 33 of the FSI that APRA should be empowered to establish and enforce prudential regulations on any licensed or approved financial entity independently from the Executive Government.[7] This was seen as important in the process of clarifying limits to the 'regulatory assurance'. The current process of making operating standards requires Treasury to advise the Government on the content of the standards which are then made by the Governor-General, rather than APRA making the standards directly. It is argued that this is inconsistent with the FSI's recommendation. There would still be appropriate checks and balances for prudential standards, such as mandatory industry consultation and Parliamentary scrutiny;

- enable complete prudential topics to be addressed within a single statement. Under the current operating standards, matters relating to a specific topic cannot always be found in a single place in the legislative framework, but across a spectrum of regulatory instruments. To date, APRA has developed superannuation circulars to comprehensively address topics in plain English. However, these circulars are not legally enforceable;

- be a faster and more flexible process than the making of regulations (operating standards). APRA would be able to make and consult on prudential standards themselves without having to involve Treasury and the Office of Legislative Drafting in the process. Treasury would be consulted on the content of the standard, but unlike the process of the making of regulations, would not be involved in the process of making the standard. There would be no need to use drafters unfamiliar with the technical subject matter (they would be drafted in-house by APRA staff), and concerns about access to scarce Parliamentary drafting resources would be eliminated. It would enable APRA to set its own drafting priorities,

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7 Financial System Inquiry 1997, Recommendation 33.

rather than being subject to the drafting priorities of the Government as a whole;

- enable standards to be written in plain English. Prescribing operating standards through regulation necessitates the use of legal language and form; and

- be consistent with other prudential regimes under which APRA has the power to make prudential standards. Those for general insurance were recently introduced and require mandatory consultation on standards that are disallowable instruments.

There are a number of practical implementation issues arising from the current legislative framework into which the prudential standards-making power would be inserted that will need to be addressed in providing such a power.

The SIS Act already contains wide powers to make subordinate instruments applicable to the operation of superannuation entities. For example, the operating standards power in Part 3 of the Act is only constrained by the requirements that standards relate to the operation of superannuation entities and are not inconsistent with the Act. Operating standards currently cover a wide range of matters including: contributions and benefits; portability; investments; governance and disclosure issues; actuarial, funding and solvency requirements; and winding-up provisions. In this respect, the SIS Act is materially different from the other prudential regimes overseen by APRA prior to the introduction of prudential standards-making powers (the *Banking Act 1959*, the *Life Insurance Act 1995* and especially the Insurance Act as amended by the GIRA).

Further, unlike the other prudential regimes, APRA is not the only regulatory body utilising the provisions of the SIS Act. ASIC also enforces certain consumer protection and disclosure provisions and the ATO administers the requirements for SMSFs. In addition, superannuation forms a key part of the Government's retirement income policy, and the SIS Act includes retirement income policy provisions as well as prudential and consumer protection provisions. The current operating standards-making power would need to remain for retirement income and consumer protection purposes.

The various types of provisions are tied through the concept of a 'complying fund' in the SIS Act. Accordingly, the bodies charged with implementing these policies — APRA, ASIC, ATO and the Treasury — all have an interest in any instruments made under the Act. Any proposed changes to give APRA a

prudential standards-making power would need to take account of these other stakeholders.

In particular, there would need to be a clear delineation between prudential regulation and retirement income policy and close consultation on any prudential standards that might have the potential to impact on retirement income aims. Care would also need to be taken to ensure that there were no inconsistencies between prudential standards made by APRA and operating standards made for retirement income purposes.

While introduction of a prudential standards-making power of itself would not require significant legislative change, as prudential standards are introduced on particular topics there would need to be restructuring of the legislation and regulations to accommodate the standard. In particular, those provisions being addressed by the standard would need to be repealed and other provisions are likely to require amendment.

Care would also need to be taken to ensure that the introduction of a power to make prudential standards did not further increase the complexity of the SIS Act. The impact on implementation and compliance costs would also need to be considered. The SWG is conscious that in its draft report released in September 2001 in relation to its *National Competition Policy Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation*, the Productivity Commission noted giving APRA increased discretion to determine standards could contribute to greater uncertainty amongst superannuation entities, requiring them in some instances to have increased resort to legal advice about the prudential standards.[8] Consideration will need to be given to how any such uncertainty can be addressed.

The SWG acknowledges that the existing operating standards power already provides a mechanism for making standards in a wide range of areas. The proposed prudential standards-making power, rather than being a new or increased power as such, can be regarded as a different process for exercising an existing power. It would provide APRA with greater flexibility in making standards, while still being subject to the same level of consultation and Parliamentary scrutiny as operating standards.

Thus, the SWG supports providing APRA with a prudential standards-making power. It acknowledges, however, that there are a number of practical implementation issues that will need to be considered and consulted on in

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8 Productivity Commission 2001, paragraph 7.4.

granting such a power, in particular, the implications for the structure of the SIS Act as a whole and for the other objectives of the Act.

Recommendation 13

The SWG recommends that APRA be empowered to make prudential standards similar to the power it has in relation to general insurance. The SWG acknowledges that there are a number of practical implementation issues that will need to be addressed progressively in relation to such a power, in consultation with relevant stakeholders.

5 LONGER TERM OPTIONS — SEPARATION OF PRUDENTIAL AND RETIREMENT INCOME PROVISIONS

Proposal

The Government seeks views on the separation of the prudential and retirement income provisions of the SIS Act.

Views from the consultation process

With a limited number of exceptions, submissions did not support the separation of prudential and retirement income provisions. A number of concerns were raised including:

- APRA needing more time and resources to apply the existing law effectively (Industry Funds Forum); and
- a preference for the current SIS regime, which encompasses internal governance requirements and has the advantage of being specialised and focused.

A number of submissions (the Trustee Corporations Association of Australia, the Australian Bankers' Association, the Australian Retirement Income Streams Association Limited, the Institute of Actuaries of Australia) favoured a separation of prudential and retirement income provisions as a longer-term objective, but indicated that this would be a very large task and did not consider it to be a high priority.

However, most submissions did not support such separation, even as a longer-term goal, and suggested that it would result in added complexity and costs, and that it would be confusing for trustees and members not to have a sole regulator responsible for superannuation.

The ATO noted that the proposal would have significant implications for it and require the resolution of a number of difficult practical issues, especially as many requirements of the SIS Act currently have both a prudential and a retirement income focus.

Participants at the focus group sessions queried the length of time such amendments would take to be finalised. Participants also expressed concerns

that a revised legislative structure consisting of three separate Acts might reduce the likelihood of the three regulators operating within a consistent policy framework.

Consideration of the proposal

The SIS Act comprises provisions covering prudential regulation, retirement income policy and investor/consumer protection. A substantial body of subordinate legislative instruments exist to give effect to these provisions and are developed in consultation with APRA, ASIC, the ATO and the Treasury.

The Issues Paper put the view that the triple targeting of the SIS Act at prudential, investor/consumer and retirement income regulation aims has contributed to legislation that is both poorly designed to achieve desired outcomes and unnecessarily complex. The joint administration of some provisions may also impede transparency and accountability for the achievement of regulatory outcomes. Accordingly, it was proposed to clearly target the arrangements by placing them in separate legislation. It was argued that this could reduce complexity, and promote clear accountability for the different limbs of the regulatory framework.

Separation of prudential and retirement income provisions may improve transparency and accountability under the SIS Act. It may also enable simplification of the regulatory framework. However, some have argued that separation, rather than simplifying, could increase the complexity of the regulatory framework — while it would leave APRA with a clear piece of superannuation prudential legislation to administer, it would mean that superannuation trustees would need to look to at least an additional piece of legislation. Industry submissions particularly highlighted this point, with ASFA commenting that the 'main benefits [of the proposal] are for the regulators, which gain their own definable patch, rather than for superannuation fund trustees, who will find it more difficult to determine and monitor their responsibilities'. The Productivity Commission also noted in its draft report that:

> 'while this option has some apparent advantages, it is not clear to the Commission whether it would reduce the overall complexity and prescription of the legislation or compliance costs. It is also not clear whether the option would increase the effectiveness of the legislation in meeting its objectives, or whether this benefit would outweigh the costs

involved with the exercise of greater regulatory discretion and additional uncertainty.[9]

The SWG supports reforms to simplify the legislative framework, including the separation of the retirement incomes and prudential elements of the SIS Act. However, it acknowledges that implementing this proposal would involve significant resources, and that care would need to be taken to ensure that the compliance burden was not increased. The SWG also considers that the Government would need to focus on simplification as the primary reason for undertaking this task, and that it should be a longer-term reform.

Recommendation 14

The SWG acknowledges that the SIS legislation is complex, and recommends separation of the prudential and retirement income provisions of the legislation to assist in simplifying the legislation. However, the SWG notes that there are a number of practical implementation issues that will need to be addressed and consulted on in relation to such a proposal.

9 Productivity Commission 2001, p. 129.

6 PRUDENTIAL STANDARDS

The SWG has recommended that APRA be given a power to make prudential standards. The SWG is of the view that APRA should consider developing prudential standards that cover capital, investment rules, outsourcing, governance and operational risk. This Chapter considers each of these issues in further detail.

Recommendation 15

The SWG recommends that APRA consider developing prudential standards that cover capital, investment rules, outsourcing, governance and operational risk, in consultation with relevant stakeholders.

6.1 Capital adequacy

Proposal

The Government invites comments on the following issues relating to capital:

- *the need to reassess capital requirements for Approved Trustees with a view to aligning those requirements with the size of the fund and the actual operational risks in each fund. This could include a capacity for APRA to vary the minimum capital standard for different types of superannuation funds;*
- *the role of capital in funds without Approved Trustees, and means of raising such capital if it is considered appropriate; and*
- *whether the option allowing the substitution of capital held in custodians is appropriate to ensure that capital is available to meet the needs of fund members.*

It should also be noted that in its draft report on the *Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation*, the Productivity Commission made the following recommendations which are relevant to this discussion:

> The net tangible asset requirements for approved trustees should be strengthened through legislative amendment. All approved trustees should be required to have a specified minimum amount of net tangible assets (or approved guarantee or combination thereof) regardless of their

custodial arrangement. Approved trustees who use custodians should not be required to have more than the specified amount.[10]

The operating capital requirements for approved trustees should be revised, through legislative amendment, so that they represent a specified proportion of an approved trustee's operating costs.[11]

Views from the consultation process

The most common comment made in submissions was that capital requirements should not be imposed on not-for-profit funds. The major reason given was that this would destroy the lower cost structure currently available to members of these funds, leading to lower retirement savings and greater concentration of superannuation assets into a small number of large funds.

It was suggested that other options such as indemnity insurance, arm's length investment rules, compliance and governance systems, including personal liability for directors, may be just as effective (the Securities Institute of Australia, the Law Council of Australia, the Meat Industry Employees Superannuation Fund, a number of smaller funds). The view was put that such options would also avoid the distortions and inefficiencies that result from the unproductive tying up of capital. As an alternative, ASFA suggested that APRA develop a system of allocating points for certain protections, with sufficient points alleviating any need to satisfy a capital requirement.

Further, it was argued that holding capital would not create a buffer against operational risk where there is a high degree of outsourcing (the Law Council of Australia), and no capital adequacy requirement will satisfactorily address a catastrophic investment loss or avert fraud (Sunsuper).

However, the Australian Bankers' Association supported imposing capital requirements on funds without Approved Trustees, suggesting that capital be raised directly by the employer(s).

The Trustee Corporations Association of Australia was among a number of organisations supporting the application of capital adequacy requirements to all commercial entities involved in operating superannuation funds, and for these requirements to take into account the number and size of the funds for

10 Productivity Commission 2001, Draft Recommendation 4.1.
11 Productivity Commission 2001, Draft Recommendation 4.2.

which services are being provided and to have regard to risk mitigation through insurance.

The Industry Funds Forum opposed any change to the existing rules in this area for Approved Trustees and noted that the key protection against operational risk is competent management of contractual risk, not capital requirements. The Investment & Financial Services Association Limited also opposed any increase in capital adequacy requirements.

NSP Buck proposed creating portfolio insurance aimed at building capital through a levy or premium rather than creating a capital reserve in isolation.

During the focus group sessions, participants generally expressed a preference for any capital requirements to be related to the risks of the fund.

Some participants also queried the rationale for enabling non-public offer funds to rely on insurance to meet the costs associated with operational failure, while requiring public offer funds (those requiring a trustee approved by APRA) to hold capital as was suggested in the draft recommendations released by the SWG on 4 March 2002.

A number of participants indicated that the removal of provisions allowing a custodian to hold capital on behalf of the trustee (as proposed in the SWG's draft recommendations) would have a serious detrimental effect on members of funds that, while having an Approved Trustee, operate on a not-for-profit basis. Stakeholders indicated that such trustees would experience difficulties in raising capital, and would be unlikely to attract investors. In the absence of other sources, trustees would be forced to seek capital holdings primarily from members. There was some discussion about the validity of these arguments given the existence and use of other reserves in not-for-profit funds with Approved Trustees to meet losses arising from operational risks. Participants queried the ability of the legislation to distinguish between profit-making and not-for-profit trustees, and between those funds making offers to the public versus those whose membership is limited.

Participants also noted that outsourcing reduces the risks directly relevant to the trustee, and that a prudent trustee board would ordinarily require a custodian to hold custody of the assets of the fund. Both of these factors should be taken into account in assessing how much capital trustees should be required to hold.

Consideration of the proposal

In the existing superannuation framework capital requirements are limited to minimum requirements for Approved Trustees. Approved Trustees are required to hold $5 million net tangible assets (NTA), an approved guarantee for that amount, or to comply with custodial conditions. Those funds that operate without an Approved Trustee are not required to hold capital.

As shown in Table 6.1.1, currently around 35 per cent of Approved Trustees are approved on the basis that the trustee holds $5 million NTA. Around 50 per cent are approved on the basis that the trustee uses a custodian, and thus hold only $100,000 NTA, or a guarantee for the amount of $5 million. Around 5 per cent of Approved Trustees are approved on the basis that an irrevocable guarantee for $5 million is in place, and around 10 per cent are approved on the basis that they invest all fund assets solely in approved prudentially regulated institutions.

Table 6.1.1: Approved Trustees by capital arrangement at March 2002

Capital arrangement	Percentage of Approved Trustees
Trustee holds $5 million NTA	35
Custodian (Trustee holds $100,000 NTA or guarantee)	50
Irrevocable $5 million guarantee	5
All assets invested in approved prudentially regulated institution	10

Source: APRA, 2002.

The Background Issues Paper proposed two options in relation to capital:

- Option 1: Reform the existing requirements applying to Approved Trustees; and
- Option 2: Bring capital requirements for non-Approved Trustees into line with requirements for Approved Trustees.

Based on these options and the views received in the first round of the consultation process, the SWG, in its draft recommendations released on 4 March 2002, suggested capital should be required for Approved Trustees and that insurance or some other risk mitigation measures should be required for other trustees. The basis for this draft recommendation was twofold:

- as raised in consultations, non-public offer funds may not need capital to show financial substance or to provide an incentive to manage the fund well; and

- given that most such funds are run on a not-for-profit basis, it would be difficult for them to access capital.

Further, some modifications were suggested to the current requirements for Approved Trustees. It was also recommended that the requirements be further refined to reflect a risk-based approach to capital over time.

In the focus group discussions in the second round of consultations, a number of concerns were raised with these draft recommendations. In particular, it was suggested that if insurance was appropriate for non-public offer funds, then it should also be appropriate for Approved Trustees.

Questions were also raised about the appropriateness of the distinction between Approved Trustees and non-public offer funds. APRA approves trustees under section 26 of the SIS Act to act as trustee for public offer superannuation funds. The majority of public offer superannuation funds offer, or intend to offer, superannuation interests to the public on a commercial basis. In contrast to trustees of non-public offer funds, many trustees approved under section 26 are investment professionals who are in the business of managing retail funds for a profit. However, there are some exceptions to this. In particular, some traditional industry fund trustees have moved into the public offer market in order to market products to a broader range of employers or directly to the public. It was suggested that the arguments for not applying capital to trustees of non-public offer funds applied equally to these not-for-profit industry funds.

In consequence, it was suggested that the appropriate distinction should be between trustees of profit-making and not-for-profit funds. Such a distinction is not currently made in the SIS Act, and the SWG believes that such a distinction would be extremely difficult to define. One suggestion was that it should be determined by the governance structure of the fund; funds with equal employer and employee representation would be regarded as not-for-profit. However, even in funds with equal representation there are activities, which seek to generate a profit from members.

In light of the focus group discussions, the SWG considers that it is not appropriate to distinguish between types of funds for the purposes of determining whether capital is required by trustees or not. Rather, if there is a justification for capital for trustees of all funds, then a requirement should be

applied across the board. However, the SWG believes that a range of factors exist which will influence the appropriate level of capital for trustees of each individual fund.

In assessing the need for and level of capital, it is essential to determine the purpose for which the capital is to be held. The reasons for requiring superannuation trustees to hold capital will not necessarily be the same as the reasons for other prudentially regulated institutions or for responsible entities of managed investment schemes.

The Background Issues Paper identified three reasons for capital requirements for superannuation trustees:

- to demonstrate financial substance and long-term commitment by the trustee;
- to have money-at-risk to provide an incentive for the trustee to manage the fund well; and
- to act as a buffer against operational or governance risk that may arise.

The focus groups considered whether each of these requirements applied to the various types of funds that exist in the superannuation industry. It was suggested that trustees of non-public offer funds need not hold capital for the first two reasons, primarily because a corporate sponsor has already demonstrated long-term commitment in setting up a superannuation fund for its employees, and because other incentives already exist to manage the fund well (for example, the obligations imposed on trustees in the covenants and liability for breach of legislative requirements).

The SWG has identified further reasons for holding capital. Firstly, capital is available to assist in the orderly wind-up of a superannuation fund (although arguably, this reason is a subset of the 'buffer against operational risk' reason). Secondly, capital can also serve as a barrier to entry, to prevent marginal players from entering the industry where the trustee does not have sufficient resources to meet the financial promises and long-term commitment necessary to operate in the industry (arguably this is a component of the 'financial substance and long-term commitment' reason).

The SWG notes that in all other industries subject to APRA's prudential regulation, capital exists as a barrier to entry ($50 million for ADIs, $10 million for life insurers, and $5 million for general insurers under the GIRA amendments). However, the proposed prudential licensing regime will

provide a mechanism for ensuring that marginal players do not enter the superannuation industry, and therefore capital may not be necessary for this purpose for superannuation trustees.

The key purpose for capital that is relevant to all superannuation funds is that it is necessary to act as a buffer against operational risk. While insurance may be available to cover some operational risks, it will not cover all of them. Furthermore, insurance suffers from the disadvantage that it requires the trustees who may have caused the loss to make the claim on behalf of members. Similarly, not all operational risk will be addressed through management of contractual risk.

Given that all funds are subject to some form of operational risk, it follows that as a matter of principle some form of capital is necessary for all trustees to ensure that operational risks can continue to be addressed on an on-going basis. While all funds will have different levels of operational risk, depending on a range of factors, there are many difficulties associated with distinguishing between capital requirements on the basis of fund type. As a result of this, the SWG believes that a risk-based framework for capital should be developed and applied to all superannuation funds as part of the licensing process, rather than as a longer term objective as originally recommended.

One of the suggested licensing requirements is that all trustees have adequate resources. The SWG considers that APRA should consider when licensing a trustee the level of capital appropriate to demonstrate 'adequate resources', particularly in relation to the operational risks faced by the funds operated by the trustee. This is consistent with the legislative requirements for responsible entities of managed investment schemes under the Corporations Act. Under those provisions, the requirement is expressed at a high level of generality (to have adequate resources), and ASIC provides further guidance in policy statements of what will be regarded as adequate in particular circumstances.

The SWG considers that the legislation should broadly identify certain factors that APRA must consider in determining whether the trustee has adequate resources. In particular, the following factors would be relevant:

- the composition of the trustee, including the trustee's skill, knowledge and experience. Independence of the trustee and equal representation will also be factors;

- the composition and quality of management, which can act as a means of increasing or decreasing capital requirements. Independence of management will be taken into account;

- governance issues, including compliance with regulatory requirements, delegation structures and outsourcing arrangements. This would include the level of residual legal risks which remain with the trustee after outsourcing (for example, the enforceability of the contract between the fund and the outsourcer and the quality of internal delegation arrangements);

- the existence and quality of internal risk management systems, including compliance committees and internal audit;

- administrative issues, including an assessment of the level of back-office activity (record keeping, reporting and other administrative tasks), soundness and efficiency of administrative and computer systems. The use of an administrator transfers some operational risk associated with, for example, systems failure, contributions and benefit payments;

- custodial arrangements, and the degree to which custodial requirements reduce overall risk. The use of a custodian can reduce the risk of fraud, identification risk and some legal risks (clearing, settlement, and safekeeping of assets);

- issues relating to investments, including internal investment experience, the role of investment managers, the quality of systems to ensure investments are within the fund's investment strategy and/or investment managers act within their mandate; and

- the type and level of insurance coverage.

Further guidance on capital requirements could also be articulated by APRA in an appropriate form such as a prudential standard or guidance note, specifying factors that increase or mitigate risk, and allocating a risk weighting to each (see Recommendation 15).

There have been some concerns expressed that the SWG's proposals might result in trustees being required to hold less than the $5 million currently required of Approved Trustees. The SWG is proposing a framework that provides, on the face of the law, the general principles, leaving the detail to be determined in standards or guidance notes. The law would not specify a minimum or maximum amount of capital required; the amount of capital required would be assessed in the licensing process based on the risks related to the fund/s being operated by the trustee. In practice, capital requirements may be more or less than the currently required $5 million, but either way, they would be much more risk-responsive.

The risk-responsive nature of the capital requirements will also enable not-for-profit funds to demonstrate a range of measures that they have taken to mitigate operational risk, which, if regarded as sufficient by APRA, may mean that they do not have to hold capital at all or only minimal amounts.

This option would also enable APRA to readjust capital if the risks to a fund changed. Ultimately APRA would have the option of revoking the licence if the trustee does not respond to requirements to increase capital holdings.

The SWG also considers that there would be benefits in removing the ability of all trustees to hold capital through either a custodian, or through a guarantee provided by an ADI.

The SWG considers that an appropriate transitional period should apply to enable trustees to make alternative arrangements for the holding of capital. APRA should also be given powers to deal with trustees that are unable to meet these requirements after the end of the transitional period.

Recommendation 16

The SWG recommends that, as a part of the licensing process, APRA should determine the amount of resources, including capital, required to be held by each trustee to address the operational risks relevant to that trustee. The legislation should list the factors APRA is required to take into account in determining an appropriate amount of capital, but should not specify a minimum or maximum amount of capital required for each trustee nor how it should be held. APRA should also provide guidance to industry on the weightings it intends to apply to those factors. The SWG recommends that the revised capital requirements be developed in consultation with relevant stakeholders, and be phased in at the same time as the licensing requirements.

6.2 Investment rules

Proposal

The Government invites comments on the development of a set of prudential standards covering the investment activities of a range of types of superannuation funds. The main aims of these standards could be to ensure:

- *that the investment objectives and strategy of the fund are consistent with the expectations of fund members;*
- *that fund investments are sufficiently diversified so excessive risks are not borne by fund members;*
- *the appropriate management and oversight of delegated activities; and*
- *that the appropriateness of investments, and the risk/return profile of the fund are assessed on a regular basis.*

Views from the consultation process

While there was some unqualified support for this proposal and some equally unqualified opposition, most submissions emphasised particular concerns.

Submissions supporting the proposal tended to emphasise the need for appropriate risk management strategies to be followed, and that this is already industry best practice.

Those opposing were generally of the view that it would be inappropriate for APRA to prescribe rules for investment of fund assets, as these are best determined by fund trustees, reflecting the wide diversity in membership profiles in various funds. For example, Jacques Martin Industry Funds Administration Pty Ltd stated that these sorts of issues are 'a "judgment call" for a suitably qualified professional, not the stuff of prescriptive rules.' Many of these submissions expressed strong opposition to an overly prescriptive approach and/or indicated that existing powers under the SIS Act were sufficient (the Australian Institute of Superannuation Trustees, the Australian Venture Capital Association, CPA Australia, the Institute of Actuaries of Australia, the Investment & Financial Services Association, KPMG, PricewaterhouseCoopers). A number suggested that it would be difficult to regulate without being overly prescriptive and that increased disclosure may be a better approach.

While submissions reflected a range of perspectives, other common themes were that:

- consistency between investment strategy and member expectations is the critical link;
- sufficient diversification is essential, but difficult to define; and

- the role of fund trustees, who need to follow appropriate risk management strategies, is critical.

Other specific comments in individual submissions included:

- support for strengthening the obligations on trustees to diversify investments, including by giving APRA the power to request, then require, a fund to follow an agreed asset diversification schedule on a case-by-case basis and to conduct field surveillance and audits to enforce arm's length rules (ASFA);

- that consideration should be given to restricting smaller superannuation funds to pooled investments in registered managed investment schemes and pooled superannuation trusts, unless they can demonstrate to APRA the ability to manage an alternative investment strategy (Westscheme);

- opposition to prescribed investment rules, as they would lead to more conservative investment strategies, diminishing retirement benefits (the Investment & Financial Services Association);

- opposition to any extension of the in-house assets 'net' or the abolition of such investments (the Small Independent Superannuation Funds Association); other submissions expressed the opposite view;

- that high-level limits should be placed on large exposures, related party dealings and excessive concentration of risk (the Trustee Corporations Association of Australia);

- that risk analysis suggests APRA should focus on smaller corporate funds where diversifiable investment risks are most likely to occur (ASFA);

- that regulation should be limited to fiduciary and integrity issues (the Australian Venture Capital Association); and

- that risks could be covered through access to capital, reserves, insurance or a statutory fund and a minimum level and increased frequency of investment reporting to trustee board meetings (NSP Buck).

In addition to particular suggestions, the ASFA submission provided a more comprehensive comparison of regulatory approaches in the OECD which drew on research undertaken by the World Bank (with evidence from the OECD). ASFA indicated that, in general terms, investments tend to be regulated in one of two ways — either through the prudent person rule more prevalent in Anglo-American countries (including Australia), or through particular

quantitative limits which are more prevalent in continental European countries. It also noted that as the prudent person approach is less prescriptive, investment returns tended to be higher in those jurisdictions that relied on that approach.

During focus group sessions most participants reiterated views expressed in written submissions that they did not feel that APRA should set prescriptive limits in this area. Discussions revolved around the need to find an independent and appropriate mechanism to certify that the investments chosen by the trustee in respect of a particular fund reflect the 'label' applied to the fund by the trustee. Participants (and particularly representatives of the auditing and actuarial profession) emphasised concerns about any proposal to require those professions to certify that the fund's investment strategy is in compliance with the fund's objectives (or further, that investments comply with the fund's investment strategy and are in compliance with 'superannuation purposes').

Some individuals preferred that APRA aggressively test its investment powers and send signals to the industry, prior to the introduction of new standards in this area.

Discussions highlighted the benefits of engaging professionals in the development of the fund's investment strategy to ensure that the strategy aligns with superannuation purposes. Such professionals would then be in a position to certify that the strategy has been developed in accordance with certain material factors, and that it was disclosed to members. It was felt that certification could be achieved through the annual compliance audit, incorporating audit of the risk management plan, which would highlight strategies used to address key risk areas particularly in relation to investments.

Participants also debated the appropriateness of the current in-house asset rules for funds with employee members. (Further discussion of in-house assets is contained in Chapter 9: Member approval for giving benefits to related parties.)

Consideration of the proposal

The SIS Act trustee covenants (contained in section 52) require superannuation funds to have investment objectives and strategies that align with member needs. In particular, the SIS Act requires that investment strategies take into account portfolio composition, diversification and liquidity. The Issues Paper indicated that this requirement has been difficult to translate into practice,

given the subjectivity involved in determining what is a sufficiently diversified and liquid portfolio, and what are appropriate goals or strategies for funds.

Under the SIS Act, the trustees are solely responsible and directly accountable for the prudent management of members' benefits. It is the trustees' duty to make, implement and document decisions about investing fund assets (including formulating and implementing an investment strategy or strategies, codified in the SIS Act as a covenant) and to monitor the performance of those assets.

In the past, APRA has released a circular in relation to investment. However, this circular needs updating and currently lacks legal backing. It could form the basis of a prudential standard in relation to investment (subject to necessary revisions).

Recommendation 17

The SWG recommends that APRA update *Superannuation Circular No. II. D.1 —Managing Investments and Investment Choice (April 1999).*

The SWG recognises that excessively tight prescription of investment classes allowed in superannuation portfolios, or other requirements designed to alleviate the problem of potential investment losses, could dramatically reduce the returns produced by funds over a long time frame, to the detriment of fund members. Such rules may also be at odds with the prudent person approach reflected in the SIS Act covenants.

The Background Issues Paper identified three options to reform the SIS investment rules:

- Option 1: Revise the existing operating standards in this area;
- Option 2: APRA could make a prudential standard relating to investments; or
- Option 3: Amend the SIS Act to require that funds have a compliance plan to ensure proper consideration of the existing provisions.

The SWG considers that there would be considerable benefits in requiring the trustees to identify in a risk management plan the measures they are adopting to ensure that the fund's investment strategy matches the fund's objectives. Firstly, it would require the trustees to document how they will ensure that the investment strategy matches the fund's objectives. This will provide an

important accountability measure. Secondly, the members would be able to access the trustee's reasoning by obtaining a copy of the risk management plan from the trustee. Thirdly, such a document would provide a useful risk management tool.

The SWG also considers that trustees should be required to ensure that the investment strategy of the fund is in compliance with 'superannuation purposes' specified in the sole purpose test contained in section 62 of the SIS Act. The sole purpose test provides that to qualify as a regulated superannuation fund, a fund must be maintained for the sole purpose of providing benefits to members on their retirement or on their reaching the age for payment of preserved benefits, or to a member's dependants or estate on the death of the member before retirement. Payment of other benefits is also approved as 'ancillary purposes' under the sole purpose test, and these include benefits on termination of employment, disablement benefits on termination of service due to ill-health, benefits to a member's dependants or to the member's estate when the member dies after retirement.

Recommendation 18

The SWG recommends that trustees be required to:

- **ensure that the fund's objectives are clearly articulated; and**
- **identify in their risk management plan the measures that the trustee is adopting to ensure that the fund's investment strategies match the fund's objectives, and are in compliance with the sole purpose test contained in section 62 of the SIS Act.**

The SWG also recommends that trustees be required to certify whether a fund's investment strategy is in compliance with the fund's objectives. This would be subject to the fund's annual compliance audit.

6.3 Outsourcing

Proposal

The Government invites comments on whether a prudential standard on outsourcing should be extended to superannuation funds, and whether the forthcoming ADI standard provides an appropriate model.

Views from the consultation process

While the submissions indicated broad support for the development of standards relating to outsourcing arrangements, there was concern with a number of aspects that could affect the implementation of outsourcing contracts. Several submissions queried whether APRA was adequately resourced to undertake such supervision. Submissions also expressed concerns in relation to:

- the provision of unspecified powers to APRA (the Industry Funds Forum);
- the requirement to give APRA prior notification before being able to make an appointment or enter into contractual obligations, particularly where timing may be critical (ASFA, the Corporate Superannuation Association); and
- applying outsourcing standards for ADIs to superannuation funds, noting the differences between the two types of entities (the Australian Bankers' Association).

The focus group sessions discussed a number of technical matters. Participants suggested that APRA should be required to notify a trustee that APRA is taking action against an outsourced party. Participants also recognised that where a small number of organisations provide services to superannuation trustees, APRA would need to consider communicating with all of the relevant trustees about any issues it may have with a particular service provider. It was noted that the trustee remains liable for the acts of its delegate. A participant also indicated that many outsourcing contracts were drafted prior to the commencement of the GST, and that any change to the contract would trigger liability for GST.

Consideration of the proposal

APRA has identified a number of concerns in relation to outsourcing activities, including:

- failure to put in place formal legal agreements for outsourcing arrangements;
- failure to execute an arrangement where a contract does exist;

- lack of coverage within agreements with respect to key risks or issues that should be considered as part of an outsourcing arrangement;
- failure to adequately specify recourse to service providers in the event of failure to fulfil obligations; and
- inadequate on-going risk monitoring control processes.

The Issues Paper proposed the development of standards for superannuation entities when entering into contracts with third parties for the provision of services, with implementation either through amendments to the SIS Act, a new operating standard or a new prudential standard.

Currently, the SIS Act only regulates custodians and investment managers to a limited extent. The operating standards power that exists in the SIS Act does not extend to making standards binding on third parties. This limits the extent to which operating standards may regulate the outsourcing of superannuation entities' functions to others. The same problem may arise in relation to a power to make prudential standards unless the relevant provisions made it clear that they could bind third parties. However, there may be a limit to the Commonwealth's constitutional power to bind third parties.

APRA does not have any formal powers in respect of service providers. Typically in other prudentially regulated regimes, APRA has required the regulated entity to include in the outsourcing contract any requirements for APRA to have access to the service provider. For example, under the new general insurance prudential standard on risk management, insurers are required to ensure that records held by a service provider are readily available at all times to the insurer and, where APRA considers it necessary, to APRA.[12] The insurer would have to ensure this is included in its contract with the service provider.

The SWG considers that universal licensing of all superannuation trustees would assist in the management of risks associated with outsourced entities. A condition could be placed on the trustee to require that they have adequate systems in place to supervise functions which have been outsourced to third parties. In addition, as with the approach taken in the insurance regime, APRA could require the trustee, as a condition of its licence, to insert a term into a contract with a service provider, that provides APRA with a right of access to the third party (this would also ensure existence of formal legal arrangements).

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12 Australian Prudential Regulation Authority 2002, *Guidance Note GGN 220.5 Operational Risks*, Sydney, July.

Both conditions would sit well within the current superannuation framework, by ensuring that the trustee retains responsibility for its own activities and those that it outsources. It would also place the responsibility on the trustee to negotiate its own contract, and would not require APRA to participate in these commercial dealings, which would require significant resources on APRA's part. A licence condition would provide sufficient flexibility to enable APRA to remove a trustee's licence if the trustee does not have appropriate arrangements in place to deal with service providers.

It was suggested during the consultation process that APRA could 'pre-vet' all service providers, rather than consider the relationship between the trustee and third parties on an individual basis. While the SWG understands that the various service provider markets are relatively concentrated, requiring APRA to pre-vet such organisations outside of the context of their relationship with specific funds would establish, in effect, a new regime of supervision, requiring additional supervisory resources. It would also require legislative amendments, given that APRA does not currently have the supervisory powers required to undertake this role. Applying conditions on the trustee's licence would appear to be a more effective use of APRA's time and resources, and would avoid restrictions related to the Commonwealth's constitutional supervisory reach by ensuring that the responsibilities continue to rest with the trustee.

Given the concentration within these sectors, it is likely that such contract terms would become the norm over time.

Requiring a trustee to prepare a risk management plan would also ensure that the trustee identifies and assesses all relevant risks, including in relation to outsourcing of services to third parties.

Recommendation 19

The SWG recommends that, as a condition of the APRA licence, trustees be required to include a term in any contracts with third party service providers that provides APRA with a right of access to the service provider in the event that APRA has concerns about the impact of the activities of the service provider on the APRA-regulated entity. The SWG also considers that APRA should be required to notify other trustees using the same service provider of any concerns APRA may have in relation to the service provider.

6.4 Governance and operational risks

Proposal

The Government welcomes comments on a reassessment of existing governance requirements on superannuation trustees and funds.

Views from the consultation process

The majority of submissions supported some formal policy or development of best practice guidelines to mitigate governance and operational risk. While not supportive of the implementation of a prudential standard that would cover governance and operational risk, most submissions were supportive of the refinement of existing requirements already in place. However, this support was qualified by the view that any new standards imposed should not be overly onerous or costly to implement or monitor.

In addition, many submissions linked the development of a more formal policy on governance and operational risk to the use of compliance plans, through which funds would be required to demonstrate how they plan to mitigate such risks as part of an audited compliance plan.

The few submissions that did not support the proposal either thought that the current arrangements were adequate and that increased monitoring by APRA would solve the problems, or that changes would unnecessarily increase an already high level of complexity. The Corporate Superannuation Association noted the importance of ensuring that trustees are well-trained and suggested that no change in regulatory approach was required.

In light of the discussions concerning risk management/compliance plans, the focus group meetings did not consider this proposal in detail.

Consideration of the proposal

Good governance promotes transparency, accountability, independence and responsibility. Ultimately these factors should promote the safety of members' funds and result in better disclosure of information to fund members. Effective risk identification and management forms a key component of sound governance. A fund's governance may be compromised without a framework for management of risks faced by it.

Operational risk is arguably the largest risk faced by superannuation funds given that investment and market risk are usually borne by fund members in accumulation funds and employers in defined benefit schemes. Operational risk is the risk resulting from a breakdown of processes, people, systems, internal controls or corporate governance, or from external events.

Components of operational risk are covered in various provisions of the SIS legislation. However, there is no all-encompassing standard that requires a superannuation fund to fully identify, assess, and manage all of the operational risks that the fund faces. While the SIS legislation does contain some requirements with respect to risk management, these tend to be widely dispersed throughout the legislation, often with little logical connection. Similarly, the requirements relating to governance are spread throughout the SIS framework.

The Issues Paper proposed either:

- the introduction of a prudential standard to cover governance and risk management, and removal of the corresponding sections from the SIS regulations; or

- combining existing provisions contained within the SIS regulations, and placing the governance and risk management-related items into one operating standard within the regulations, rather than having multiple provisions covering various topics as is currently the case.

The SWG considers that a licence condition should require all trustees to have appropriate risk management systems. This would ensure that a particular standard is applied to all trustees. In addition, the SWG considers trustees should also be required to address in their risk management plan how they intend to comply with various provisions relating to governance and operational risk

Recommendation 20

The SWG recommends that, as a component of the licensing framework, trustees be required to demonstrate in their risk management plan how they propose to deal with governance and risk management requirements.

7 ANNUAL MEETINGS

Proposal

The Issues Paper proposed two options:

- superannuation funds be required to hold annual general meetings (AGMs) (along the lines of the provisions in section 250N of the Corporations Act); or
- superannuation fund members be given the right to request a meeting at any time (as registered managed investment schemes are required to do).

The Government welcomes comments on these options, including the extent of powers that members could have (for example, voting powers to remove trustees or fund managers, or whether members could only seek, through a meeting, more detailed information and explanations from trustees and managers).

Views from the consultation process

Industry submissions indicated almost universal opposition to the proposal to hold AGMs. The concerns raised related to compliance costs, that would be passed on to members, and implementation practicalities. These included the difficulty in determining voting rights, the potential for AGM resolutions to conflict with trust law requirements (for example, trustees cannot be subject to member direction, and they must ensure that their duties and powers are performed and exercised in the best interests of the beneficiaries), and the lack of support by members for such proposals previously.

However, some submissions noted that the objective of the proposal of improving member activism could still be achieved through other means, such as provision of information to members and member education. The Australian Industry Group supported 'the paramount need for suitable communications and consultative mediums between trustees and fund members.' The Trustee Corporations Association of Australia suggested that an independent compliance body could act as 'member champion' if directed by the regulator or members.

Participants at the focus group sessions did not oppose the SWG's draft recommendation, that the proposals to require superannuation funds to hold

AGMs or that members be given the right to request a meeting at any time not be proceeded with. However, one participant did suggest that there would be benefits in providing members with an opportunity to voice concerns to a collective body of members.

Consideration of the proposal

The purpose of this proposal was to give members the opportunity to hold trustees to account more directly — effectively bringing superannuation into line with other similar types of investments (for example, managed investment schemes). It was seen as an opportunity to increase member activism and for members to have a greater say over their retirement benefits. It could also facilitate greater member scrutiny of fund activity.

As noted above, submissions were not supportive of the proposals and a number of concerns were raised, including:

- the interaction with the trust structure for superannuation funds and the established trust relationships including fiduciary obligations;
- establishing appropriate allocation of voting rights;
- other implementation difficulties, including how members might be able to get time off work to attend meetings; and
- compliance costs.

In many employer-sponsored funds, the equal representation rules provide an avenue for members to become involved in the operation of their fund. There are also a number of other mechanisms for members to voice dissatisfaction with their fund, including via internal dispute resolution arrangements and through the Superannuation Complaints Tribunal.

This proposal was aimed at facilitating better member scrutiny of trustee performance. Other recommendations of the SWG, in particular those relating to licensing and increased disclosure, will also assist in achieving this objective.

The SWG agrees that there would be benefits in providing members with an opportunity to voice concerns to a collective body of members. However, the SWG considers that it would be inappropriate to mandate this requirement in legislation, and encourages trustees to provide such opportunities to members.

Accordingly, the SWG considers that:

- the protections already in place offer better opportunities for fund members to communicate with the trustee and to query various decisions than either of the proposals put forward; and
- the concerns underlying the proposals for member meetings could be dealt with more effectively by better disclosure and a greater compliance focus.

Recommendation 21

The SWG recommends that the proposals contained in the Issues Paper, to require superannuation funds to hold AGMs or that members be given the right to request a meeting at any time, not be proceeded with.

8 PUBLIC DISCLOSURE OF ANNUAL RETURNS

Proposal

The Government welcomes comments on whether all superannuation fund annual returns be made public either through ASIC or APRA.

Views from the consultation process

Submissions generally supported increased public disclosure of annual returns. Most of the supporters agreed that transparency would be enhanced through improved disclosure.

Those who did not support this proposal considered that only members of funds really need such information (and they already receive it), particularly given that employer-sponsored funds are not open to the public.

Other comments related to the need to address compliance costs, commercial sensitivities and privacy issues (ASFA). It was also noted that insufficient uniformity in the way in which fees and investment returns are disclosed made it harder to make meaningful comparisons (HortSuper). It was also suggested that '[r]ather than prescribing new rules for all, it would be more efficient to lift the standards for those funds where such information is not yet readily available' (the Securities Institute of Australia).

During focus group sessions, participants suggested that any recommendations on this issue incorporate an assessment of the likely costs and benefits of the proposal prior to development. Participants also suggested the need for information to be disclosed in a uniform manner, and that a template for trustees to use would assist uniformity of reporting.

Consideration of the proposal

The aim of this proposal is to make trustees more accountable and increase market transparency by making key superannuation fund financial information available to the public and market at large. Making such information publicly available could enable the market to better scrutinise fund performance and would place greater discipline on trustees.

The SWG acknowledges that trustees are required to make a range of information available to members through existing disclosure requirements, and that trustees are also required to provide financial information to APRA.

The requirements for disclosure of fund and member-specific information to members are contained in the Corporations Act, following the commencement of the FSRA on 11 March 2002. The provision of information is restricted to fund members, with no requirement for full public disclosure.

While trustees are obliged to provide information to members under the disclosure requirements, information provided by trustees to APRA (annual returns and audited financial statements) is not made available to fund members. However, the information APRA receives via annual returns will be reported to members in some instances as part of the annual reporting requirements, most notably the statement of financial position and the statement of net assets. Members may also ask for a copy of the audited financial statements. However, this information is not always available to the market to enable on-going comparisons.

In many employer-sponsored funds, the equal representation rules provide an avenue for members to be more involved in the operation of their fund.

Submissions generally indicated support for improved disclosure to the wider community of information about fund performance. There is a question of how much information should be disclosed to the public: all of the information provided to APRA in its annual returns; only fund information that is provided to members and audited financial accounts; or some combination of the two?

Information currently provided to APRA in annual returns is supplied for prudential purposes and it may not be appropriate for all of that information to be disclosed to the public. Further, APRA is currently conducting a review of the information required in annual returns in the context of the implementation of the *Financial Sector (Collection of Data) Act 2001* (the Data Act). In light of that review, the SWG considers that at this stage the information that should be disclosed to the public should be the fund information that is provided to members, along with the audited financial statements. This is consistent with the requirement for responsible entities of registered managed investment schemes to make public the annual reports for registered schemes.

Once APRA has completed its review of the annual return information, further consideration could be given to whether there is any additional information that could usefully be disclosed to the public at large.

The Issues Paper proposal covered all regulated superannuation funds, except SMSFs and EPSSSs. The SWG is conscious that there could be privacy concerns associated with making public the financial statements of funds with a small number of members. It proposes, therefore to also exempt from these publication requirements small APRA funds (those with fewer than five members which are required to have an Approved Trustee).

The Issues Paper suggested that either APRA or ASIC could make this information available on their public databases. There was little comment in submissions about which regulator should make this information available.

APRA has an existing database, and is enhancing its annual return collections and data warehousing systems as it implements the requirements of the Data Act. While APRA receives annual return information, it does not have a readily available system to make this information publicly available at this time.

ASIC is generally responsible for disclosure to members and has existing comprehensive data systems and search facilities. By amending certain regulations, ASIC would be able to require that fund information provided to members be forwarded to them, and may be the appropriate regulator to provide this disclosure function in the first instance.

Recommendation 22

The SWG recommends that for funds other than those with fewer than five members and EPSSSs, ASIC use its existing electronic facilities to make the audited accounts of funds and the fund information required to be given to members publicly available, provided the costs are reasonable.

At present, while members of superannuation funds are given summary financial information and can request the audited financial statements of the fund, there is no requirement that they be advised of a qualification on the auditor's report. The SWG considers that, as an additional measure to improve trustees' accountability, particularly given the important role proposed to be played by the audited risk management plan, any qualification of the auditor's report should be notified to members. This could either be required to be disclosed annually or as a 'significant event' (defined in the on-going disclosure requirements included in the Corporations Act by the FSRA).

Recommendation 23

The SWG recommends that trustees be required to notify superannuation fund members of the presence, and nature, of any qualification of the fund's auditor's report.

9 MEMBER APPROVAL FOR GIVING BENEFITS TO RELATED PARTIES

Proposal

The Government welcomes comments on whether members must approve the giving of benefits to related parties by the superannuation fund trustee.

Views from the consultation process

With only a few exceptions, submissions did not support the proposal to require members to approve the giving of benefits to related parties.

Some submissions (ASFA, the Industry Funds Forum, the Corporate Superannuation Association) opposed adopting the relevant provisions of the Corporations Act, arguing that the existing protections provided in the SIS Act are stronger. A number of submissions questioned the proposal on the grounds of practicality, indicating that it would be virtually impossible to get member approval for the giving of benefits to related parties, especially for larger funds. Clear disclosure to members was suggested as a better alternative.

Other submissions also indicated that the proposal would only be appropriate if the trustee intended to purchase new in-house assets that are not listed investments. Concerns were also raised in relation to multi-employer funds, where equity investments in those employers are managed at arm's length.

Related party transactions were also raised in the focus group discussions on a possible prudential standard to be developed on investment rules.

One participant indicated that it would be necessary to avoid duplication of current requirements in accounting standards which deal with related parties.

The Small Independent Superannuation Funds Association also expressed a concern that while the SWG had indicated an intention to exempt SMSFs from the other proposals, it was not clear whether it was intended that this proposal also apply to SMSFs.

Participants generally supported the view that the current grandfathering period for funds other than SMSFs could be reduced, particularly for standard employer-sponsored funds.

Consideration of the proposal

There are a number of different kinds of related party transactions that can arise in relation to superannuation, including dealings with members, investments in assets of the employer and transactions with service providers who are related to the trustees of the fund. The SIS Act includes a number of provisions dealing with the first two kinds of related party transactions (the in-house asset rules), designed to limit the risks associated with superannuation fund investments, and to ensure that superannuation savings are preserved for retirement purposes.

Substantial amendments were made to the in-house asset rules with the passage of the *Superannuation Legislation Amendment Act (No. 4) 1999*, which came into effect on 23 December 1999. In summary, the amendments widened the application of the in-house asset restrictions to related parties of a fund, and included, as in-house assets, investments in a related trust and any assets subject to a lease or a lease arrangement with a related party.

An in-house asset of a fund is:

- a loan to, or investment in, a related party of the fund; or
- an investment in a related trust of the fund; or
- an asset of the fund subject to a lease arrangement between the trustee of the fund and a related party.

The amount of in-house assets that a fund may have is generally limited to five per cent of the market value of a fund's assets.

Significant grandfathering provisions were attached to these requirements. Transitional provisions allow fund investments or leases in place at 11 August 1999, and that were not in-house assets at the time, to continue without being subject to the new rules. While the permitted level of in-house assets generally remains capped at five per cent of fund assets, the transitional rules allow additional investments in existing related party assets to be made until 30 June 2009 in certain limited circumstances. Some of the concerns that have

been raised in relation to in-house assets have arisen as a result of this grandfathering.

Recommendation 24

The SWG recommends that the Government consider reducing the length of time that grandfathering arrangements contained in Part 8 of the SIS Act apply for all funds other than SMSFs.

The SWG accepts that there is not a compelling case to change the existing in-house asset provisions. However, the SWG considers that the level of disclosure of in-house assets, including whether funds have any assets/liabilities that are covered by the grandfathering regime, is not sufficient. Public offer superannuation funds are required to provide prospective members with information before the individual becomes a member. Other funds must give members information within three months of the person becoming a member. Following the FSRA, this information will be required to be given in a Product Disclosure Statement (PDS). The SWG considers that it would be appropriate for trustees to disclose in the PDS any in-house assets held by the fund.

Recommendation 25

The SWG recommends that trustees be required to disclose in their PDS any in-house assets held by the fund.

Further, the current provisions do not address other related party transactions, including related service provider arrangements. While the SWG agrees that member approval for such transactions is unlikely to be practical, it believes that there should be some disclosure to members of any such transactions that are entered into on non-arm's length terms. Trustees could be required to include in the PDS any associations that they have with service providers and then disclose as a significant event any non-arm's length transactions that they have entered into with such service providers. This could be achieved by expanding the definition of 'significant event' in the on-going disclosure requirements included in the Corporations Act by the FSRA.

Recommendation 26

The SWG recommends that trustees be required to disclose non-investment transactions entered into with related parties.

10 FINANCIAL ASSISTANCE TO FAILED SUPERANNUATION FUNDS

Proposal

The Government invites comments on the circumstances under which Part 23 could be broadened, and how any compensation should be funded, including whether funding of broader compensation arrangements by industry levies would be supported.

The Issues Paper indicated that Part 23 could be broadened to include misleading or deceptive conduct as grounds for a claim for financial assistance.

Views from the consultation process

There was very little support for the broadening of Part 23 of the SIS Act to include financial assistance for acts that are misleading or deceptive. Many submissions indicated that Part 23 had not yet been tested, and that changing existing provisions before it could be determined whether they were operating effectively was not in the best interests of the industry.

Submissions were concerned that a broadening of Part 23 would increase the burden on effectively managed, low-risk funds to provide compensation for poorly managed, high-risk funds. Submissions also suggested that widening Part 23 would lead funds to reduce their own levels of protection, resulting in increased moral hazard, which was not considered appropriate. The Securities Institute of Australia stated that it 'does not support any broadening of such assistance at this stage, due to the inherent moral hazard involved and to the difficulty in defining what sorts of losses would be protected, given the absence of explicit promises'.

Further, most submissions were not supportive of a levy system to provide compensation, preferring that it be provided by some form of insurance or consolidated revenue. AMP indicated that '[a]n industry assistance fund could in the longer term act as a disincentive for prudent risk management with the cost of failure being borne by prudent trustees and their members.'

ASFA supported reworking Part 23 to ensure a more timely and efficient application of the current provisions, and expressed support for the capping of restitution and the implementation of a more formal definition within Part 23 of 'substantial diminution'.

A participant at the focus group sessions expressed concern about the current processing of applications under Part 23, and queried the benefits of deferring legislative change given these delays.

Consideration of the proposal

Part 23 of the SIS Act provides a framework for providing financial assistance to regulated superannuation funds (other than SMSFs) that suffer an 'eligible loss' (defined in the SIS Act) as a result of fraudulent conduct or theft, subject to certain conditions. For an accumulation fund, the loss must have caused substantial diminution of the fund leading to difficulties in the payment of benefits. For a defined benefit fund, the eligible loss is so much of a loss that a standard employer-sponsor is required to pay to the fund, but would be unable to do so without becoming insolvent. Further, the Minister must determine that the public interest requires that a grant of financial assistance be made.

There does not need to be a conviction for fraudulent conduct or theft; rather, it is for the Minister making the determination to be convinced in his or her mind that fraudulent conduct or theft did occur.

If the Minister determines to grant financial assistance, he or she must also determine whether the assistance is to be paid out of:

- the Consolidated Revenue Fund; or
- the Superannuation Protection Reserve funded through a levy on certain superannuation funds.

The Issues Paper invited comment on the circumstances under which Part 23 could be broadened, and how any compensation might be funded.

This proposal was aimed at addressing concerns that the provisions of Part 23 may not be sufficiently broad to meet community expectations about financial assistance to failed superannuation funds. However, the SWG acknowledges that, in light of existing Government policy that financial assistance be funded by industry levies, any expansion in the test could increase the burden on well-run superannuation funds.

As with other financial investments, the Government does not explicitly guarantee superannuation savings. However, given the special characteristics of superannuation — compulsion, preservation rules, limited choice and

portability — as well as its role in retirement income policy, the SIS Act does provide protection for superannuation fund members that suffer loss as a result of fraudulent conduct or theft.

Such a safety net was supported by the FSI, although the FSI suggested certain limits on the provision of financial assistance:

> 'Where losses as a result of serious fraud are incurred by beneficiaries of superannuation funds (other than excluded funds), the Treasurer should have powers, on the advice of the [APRA] to levy superannuation providers at a rate not exceeding 0.05 per cent of assets where such restitution is considered to be in the national interest. Restitution should be limited to 80 per cent of the original entitlement of beneficiaries as determined by [APRA] ...'[13]

While the Government accepted this recommendation, no changes to Part 23 have been made to give effect to it.

The Senate Select Committee on Superannuation and Financial Services has highlighted the amount of time required to assess applications under Part 23, and recommended that the Government look at ways to expedite the process.[14] Industry submissions also flagged concern that the decision-making process under Part 23 is too slow.

As noted above, prior to making a grant of financial assistance, the SIS Act requires that certain tests be met. The legislation provides the Minister with discretion to determine whether these tests have been met.

To assess whether there has been a loss suffered by a fund as a result of fraudulent conduct or theft, that has caused a substantial diminution of the fund leading to difficulties in the payment of benefits, requires a thorough assessment of the circumstances of the loss. Ascertaining these details is not simple, and recovery action or investigations can take some time. This reflects the general complexity of events surrounding fund failures.

A decision on a grant of financial assistance that is made prior to gaining and assessing all of the facts could be challenged on administrative or judicial grounds. The likelihood of challenge on these grounds may increase where a grant is funded by levies on other superannuation funds.

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13 Financial System Inquiry 1997, Recommendation 55.

14 Senate Select Committee on Superannuation and Financial Services 2001a, Recommendation 6.

Further, while a number of applications are currently being considered under Part 23, no decisions have yet been made. Thus, the provisions of Part 23 have not been fully tested in practice.

Given that the effectiveness of the current provisions has not been fully tested, and the lack of industry support for any change, it seems inappropriate to recommend changes to Part 23 at this time. Further, any legislative changes arising from a review by the Government of the provisions after a Part 23 determination has been made could not have retrospective effect, and thus would not provide relief for current applications pending determination.

Recommendation 27

Given that the current provisions contained in Part 23 of the SIS Act have not yet been fully tested, the SWG recommends that the provisions not be changed at this time. However, the SWG recommends that the Government review the operation of Part 23 and consider possible amendments to it, in consultation with relevant stakeholders, once the first decision under Part 23 has been made.

11 OTHER ISSUES

This Chapter highlights issues that were raised in consultations, but were not canvassed in the Issues Paper.

11.1 Education of trustees and members

During focus group sessions, participants indicated that the Government and industry needed to work together to provide sufficient training to trustees and education of members.

Many of the issues regarding trustee training will be addressed under the ASIC and proposed APRA licensing regimes.

In relation to education of members, the SWG encourages the regulators to make full use of the opportunities to remind members of the importance of understanding their superannuation arrangements.

11.2 Contributions

The Industry Funds Forum requested in its written submission that 'arrears' procedures in superannuation be considered to ensure the timely collection and allocation of compulsory employer-sponsored superannuation contributions. They put the view that an Approved Trustee that collects compulsory employer contributions should also be required to satisfy APRA that it has an established arrears procedure in place, to ensure that reasonable endeavours are made to recover unpaid contributions and that contributions are made on a regular basis.

The issue of outstanding contributions is important when considering measures to improve the safety of superannuation.

In relation to timing of remittance of contributions, the SWG notes that member contributions deducted from payroll are subject to remittance requirements set out in section 64 of the SIS Act, and that superannuation guarantee contributions are subject to timing requirements set out in the *Superannuation Guarantee Administration Act 1992*.

The SWG notes that with respect to superannuation guarantee contributions, the Government announced during the 2001 election campaign that from

1 July 2003, it would require employers to make at least quarterly superannuation guarantee contributions on behalf of employees, rather than yearly. It is understood that the proposed quarterly arrangements would not apply to non-mandated employer contributions or employee contributions.

With respect to employee contributions, the SWG notes that the SIS Act was amended in January 2001 to provide that it is a strict liability offence for the employer to fail to pay the amount deducted from the employee's salary or wages to the trustee of the fund within 28 days of the end of the month in which the deduction is made.[15]

The SWG believes that consideration should be given to the need for timeframes for remittance of salary sacrifice contributions that are not regarded as compulsory employer contributions to satisfy superannuation guarantee obligations. For such contributions, the time for payment is dependent on the agreement between the employer and the employee.

Recommendation 28

The SWG recommends that the Government consider examining the need to specify a timeframe within which salary sacrifice superannuation contributions should be paid to a superannuation fund on behalf of an employee.

15 Section 64 of the SIS Act was amended by the *Financial Sector Legislation Amendment Act (No. 1) 2000*.

APPENDIX 1: SWG CONSULTATIONS

This Appendix lists the organisations and individuals that sent submissions into the SWG and attended SWG consultation meetings.

List of submissions received[16]

AMP Limited

Association of Superannuation Funds of Australia Ltd

Attorney-General's Department, Criminal Justice Division

Australian Bankers' Association

Australian Council of Trade Unions

Australian Custodial Services Association

Australian Industry Group

Australian Institute of Superannuation Trustees

Australian Retirement Income Streams Association Limited

Australian Taxation Office

Australian Venture Capital Association Limited

Coles Myer Superannuation Fund Pty Ltd

Commonwealth Bank of Australia

Corporate Superannuation Association Inc

CPA Australia

Financial Planning Association

16 The SWG received 52 submissions, 50 of which are listed. Two submissions are not listed. The first submission is not listed on the basis that it contained 'personal' information. The second submission is not listed on the basis that the submitter requested that it not be made public as it contains commercial information of a confidential nature.

Graham Swanston

HortSuper

Industry Funds Forum Inc

Institute of Actuaries of Australia

Institute of Chartered Accountants in Australia

Investment & Financial Services Association Ltd

Jacques Martin Industry Funds Administration Pty Ltd

Jan F Sharples

John D Malone

Joint submission (prepared by Independent Fund Administrators & Advisers Pty Ltd) from Allied Unions Superannuation Trust (Queensland); Austsafe Super; Club Super; Queensland Independent Education and Care Superannuation Trust; Sisters of Mercy Staff Superannuation Scheme; Superannuation Plan for Electrical contractors (Qld)

J P McAuley

KPMG

Law Council of Australia

Law Institute of Victoria

MAP Funds Management Ltd

Meat Industry Employees Superannuation Fund

NSP Buck Pty Ltd

Perpetual Trustees Australia Limited

Plan B Financial Services Ltd

PricewaterhouseCoopers

Property Investment Research

Queensland Coal and Oil Shale Mining Industry Superannuation Fund

R J Eagle

Remuneration Concepts Pty Ltd

R J Watson

Securities Institute of Australia

Small Independent Superannuation Funds Association

Sunsuper

Superannuation Complaints Tribunal

Telstra Super Pty Ltd

Towers Perrin

Trustee Corporations Association of Australia

Westscheme

William M Mercer Pty Ltd

List of organisations or individuals represented at SWG consultation meetings

Roundtable meeting in Canberra: 13 December 2001

AMP Limited

Association of Superannuation Funds of Australia Ltd

Australian Chamber of Commerce and Industry

Australian Council of Trade Unions

Australian Industry Group

Australian Institute of Superannuation Trustees

Australian Retirement Income Streams Association Limited

Australian Taxation Office

AXA Asia Pacific

Corporate Superannuation Association Inc

CPA Australia

Deloittes Touche Tohmatsu

Ernst & Young

Financial Planning Association

Industry Funds Forum Inc

Institute of Actuaries of Australia

Institute of Chartered Accountants in Australia

Investment & Financial Services Association

Jacques Martin Industry Funds Administration Pty Ltd

KPMG

Law Council of Australia

Meat Industry Employees Superannuation Fund

PricewaterhouseCoopers

Professional Financial Solutions

Queensland Coal and Oil Shale Mining Industry Superannuation Fund

Small Independent Superannuation Funds Association

Superannuation Complaints Tribunal

Telstra Super Pty Ltd

Towers Perrin

Trustee Corporations Association of Australia

Wealth Management Division of National Australia Group

Westscheme

William M Mercer Pty Ltd

Focus Group Meeting 1 in Sydney: 6 March 2002

AMP Limited

Association of Superannuation Funds of Australia Ltd

Australian Industry Group

Australian Institute of Superannuation Trustees

Australian Retirement Income Streams Association Limited

Australian Taxation Office

Australian Consumers Association

CNAL Support Group

Corporate Superannuation Association

CPA Australia

Financial Planning Association

HortSuper

Investment & Financial Services Association Ltd

Institute of Actuaries of Australia

KPMG

NSP Buck Pty Ltd

Perpetual Trustees Australia Limited

Queensland Coal and Oil Shale Mining Industry Superannuation Fund

Securities Institute of Australia

Small Independent Superannuation Funds Association

Trustee Corporations Association of Australia

University of Sydney

William M Mercer Pty Ltd

Focus Group Meeting 2 in Melbourne: 7 March 2002

Australian Custodial Services Australia

Australian Bankers' Association

CNAL Support Group

Council of Small Business Organisations of Australia

Ernst & Young

Jacques Martin Industry Funds Administration Pty Ltd

Industry Funds Forum Inc

Law Institute of Victoria

MAP Funds Management Ltd

Meat Industry Employees Superannuation Fund

NSP Buck Pty Ltd

PricewaterhouseCoopers

Property Investment Research

Telstra Super Pty Ltd

Watson Wyatt Worldwide

Westscheme

William M Mercer Pty Ltd

APPENDIX 2: OTHER DEVELOPMENTS IN THE REGULATION OF SUPERANNUATION

This Appendix lists other developments in the superannuation industry that will have an impact on supervisory arrangements for superannuation funds.

- In 2001, APRA received $2.1 million for 2001-02, and $3.1 million for 2002-03 and on-going, for increased prudential supervision of superannuation.

- APRA has significantly increased supervisory activity of superannuation funds. Visits to individual funds are expected to increase from just under 600 in a year to June 2001 to around 1,000 in the current financial year. Around 80 consultations or visits will also be held with Approved Trustees or financial conglomerates which include superannuation entities.

- The *Financial Sector Legislation Amendment Act 2001* commenced in January 2001. The Act provided the regulators (APRA, ASIC and the ATO) with a range of new enforcement powers, including the power to disqualify persons considered not 'fit and proper' to be involved in administering superannuation, and the ability to accept voluntary undertakings from persons involved in superannuation administration, and to enforce such undertakings through a Court. The Act also converted certain offence provisions under the SIS Act from fault liability to strict liability, and converted certain fault liability offences to two-tier offences with both fault and strict liability limbs.

- The licensing provisions of the FSRA commenced on 11 March 2002.

- APRA is in the process of refining the annual returns and reporting requirements for superannuation funds to ensure that data reported by funds is comprehensive and accurate, with the ultimate aim of ensuring that information is timely and relevant, and assists APRA to identify and address areas of potential concern before they become significant.

- Full implementation of the changes to reporting deadlines for non-public offer funds from nine or six months to four months came into effect in 2001.

- In 2001, the Senate Select Committee on Superannuation and Financial Services, chaired by Senator Watson , released three reports dealing with prudential supervision and consumer protection of superannuation. The first report, released on 20 August 2001, recommended enhancing APRA's enforcement culture, improving communication between APRA, ASIC and

the community, improving trustee training, more effective resourcing of the regulators and reviewing aspects of the SIS Act referred to in the report.[17] The second report, released on 30 August 2001, examined a number of 'case studies',[18] and the third report, released on 24 September 2001, examined the role of auditors.[19] The Government is currently considering these reports and will release its response in due course.

- The Productivity Commission released its draft report on the National Competition Policy review of certain superannuation Acts on 19 September 2001.[20] The key recommendations of the report were to amend the SIS Act with a view to removing unnecessary restriction of competition; to reduce compliance costs; and to require that all superannuation entities be licensed by APRA subject to such matters as trustee capacity, operating capital and appropriate investment strategy. The Government is currently considering the final report and will release its response in due course.

- On 4 October 2001, the Government welcomed a report by Professor Ian Ramsay on auditor independence in Australia.[21] Key recommendations included preventing former audit partners from becoming directors of the companies they have audited within two years of them leaving the audit firm; preventing companies having directors who are also an immediate relative of someone auditing their company; requiring auditors to disclose the dollar value of non-audit work they do for the company; and changing the ASX Listing Rules to require all listed companies to have an audit committee.

- The Government announced a range of commitments during the 2001 election campaign in its document 'Our Future Action Plan — A Better Superannuation System'.

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17 Senate Select Committee on Superannuation and Financial Services 2001a.

18 Senate Select Committee on Superannuation and Financial Services 2001b, *Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services Second Report — Some Case Studies*, (Senator J. Watson, Chair), Canberra, August.

19 Senate Select Committee on Superannuation and Financial Services 2001c, *Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services Third Report — Auditing of Superannuation Funds*, (Senator J. Watson, Chair), Canberra, September.

20 Productivity Commission 2001.

21 Prof. Ian Ramsay 2001, *Independence of Australian Company Auditors Review of Current Australian Requirements and Proposals for Reform*, Report to the Minister for Financial Services and Regulation, Canberra, October.

- On 3 December 2001, Mr Malcolm Turnbull submitted his written report to Government on the review of the effectiveness of the arrangements for the regulation of managed investments introduced by the *Managed Investments Act 1998*, contained in Chapter 5C of the *Corporations Act 2001*. [22]

22 Malcolm Turnbull 2001, *Review of the Managed Investments Act 1998*, Report to the Minister for Financial Services and Regulation, Canberra, December.

APPENDIX 3: EXAMPLES OF RECENT ISSUES FOR SUPERANNUATION FUNDS

This Appendix provides examples of recent issues faced by specific superannuation funds. The examples demonstrate that concerns have arisen in relation to a variety of funds: those with Approved Trustees and funds which do not have an Approved Trustee, as well as funds of varying sizes and structures. The following examples have been sourced from APRA media releases and the reports released by the Senate Select Committee on Superannuation and Financial Services in relation to its reference on prudential regulation and consumer protection of superannuation, banking and financial services.

- The Corrections Corporation Staff Superannuation Fund, a medium sized corporate-sponsored fund, liquidated most of its assets to pay out staff leaving the fund following the loss by the corporation of contracts to provide services to prisons. This resulted in one of the assets of the fund, a 'near CBD' commercial property (representing a large proportion of the value of the fund's assets) being sold at a substantial discount to its book value. The fund's investment strategy had been disclosed to members, and there was no evidence of fraud or malpractice.[23]

- The Media Labs Superannuation Fund, a corporate fund with 58 members and $72,000 in assets, invested in specialised recording equipment that was leased to the fund's employer-sponsor on less than commercial terms. In this example, APRA used its enforceable undertaking power for the first time to resolve the issue.[24]

- The Hairdressers Association Superannuation Fund, an industry fund, with about 4,000 members and $3 million in assets at the relevant time, suffered financial difficulties in the pre-SIS Act environment in the early to mid 1990s, including significant negative returns to members during the 1994-95 financial year, resulting from two large investments by the former trustee. The difficulties can be attributed to a lack of a formal investment strategy

23 APRA media release, *APRA Receives Corrections Corp Staff Super Fund Draft Report*, 22 August 2001.

24 APRA media release, *APRA obtains first enforceable undertaking from trustees of superannuation fund*, 6 December 2001.

resulting in the failure to adequately diversify investments; significant related party dealings; and a lack of appropriate disclosure to members.[25]

- In relation to Commercial Nominees of Australia Limited, an Approved Trustee for three public offer superannuation entities and about 500 small superannuation funds with fewer than five members, both APRA and ASIC have identified many areas of concern, such as inappropriate investments, non-arm's length transactions, lack of appropriate disclosure of investments to members, and inappropriate management procedures. A large proportion of the losses experienced by the superannuation funds related to investments in unit trusts also under the trusteeship of Commercial Nominees.[26]

- The former trustee of the Employee Productivity Award Superannuation fund, an industry fund with an Approved Trustee, with 26,000 members and with $27 million in assets in 1997, advised members in September 1998 of substantial asset write-downs and consequential negative returns for the 1997-98 year. ASIC has begun civil proceedings in the Queensland Supreme Court against the former trustee, its directors, and the 1995-96 auditors of the fund, seeking damages of more than $10 million. ASIC has alleged that from 1994 to 1998 the former trustee and its directors made various inappropriate investment decisions, including investments which were imprudent and speculative; loans made without adequate security; and loans made on a non-arm's length basis.[27]

- The Law Employees Superannuation Fund, a fund with a corporate trustee comprising equal representation of employers and members, with 5,700 members, is an example of poor investment performance, arising from investments made during the mid-1990's; significant administration fees; ineffective disclosure to members, particularly in regards to the fund's performance; and concerns about the effectiveness of the equal representation structure in enabling members to voice their concerns to the trustee, particularly with respect to the fund's investment strategy.[28]

- In 2001, APRA gained Federal Court orders against the trustee directors of the Wes Lofts (Aust) Superannuation Fund, a corporate-sponsored fund with about 50 members and assets of approximately $1.7 million, over the employer's improper use of members' funds. The trustee directors

25 Senate Select Committee on Superannuation and Financial Services 2001b, Chapter 2.
26 APRA media release, *APRA revokes trustee approval*, 14 February 2001.
27 Senate Select Committee on Superannuation and Financial Services 2001b, Chapter 1.
28 Senate Select Committee on Superannuation and Financial Services 2001b, Chapter 3.

consented to orders declaring they had procured contraventions of the in-house asset rules by the fund. In addition, the Court declared that the trustee had entered into a scheme to artificially reduce the level of the fund's in-house assets.[29]

29 APRA media release, *APRA gains civil penalty orders against Wes Lofts Superannuation Pty Ltd*, 30 October 2001.